75-580 1

IN THE

Supreme Court of the United States

OCTOBER TERM, 1975

No. 75-..................

ALLIS-CHALMERS MANUFACTURING COMPANY,

Petitioner,

—v.—

GULF & WESTERN INDUSTRIES, INC.,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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Allis-Chalmers Manufacturing Company,

Petitioner,

—v.—

Gulf & Western Industries, Inc.,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

Petitioner Allis-Chalmers Manufacturing Company ("Allis-Chalmers") prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Seventh Circuit entered on September 29, 1975.

Opinions Below

The opinion of the United States Court of Appeals for the Seventh Circuit, rendered on September 29, 1975 and as yet unreported, is set forth in Appendix A hereto. The opinion of the United States District Court for the Northern District of Illinois is reported at 372 F.Supp. 570 (N.D. Ill. 1974), and is set forth in Appendix B hereto.

Jurisdiction

The judgment of the Court of Appeals was entered on September 29, 1975. Prior to the entry of judgment, the Court of Appeals *sua sponte* circulated the opinion among all the active judges of that court because, as was candidly acknowledged, the court "adopt[ed] a position on an issue as to which a conflict between circuits exists". 6a n.5.* A majority of the active judges did not request rehearing *en banc,* Chief Judge Fairchild and Judge Cummings voting for rehearing. This Court has jurisdiction pursuant to 28 U.S.C. § 1254(1).

Statute Involved

Section 16(b) of the Securities Exchange Act of 1934, 48 Stat. 896, 15 U.S.C. § 78p(b), provides:

> "For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection."

* Citations to "__a" are to the Appendices attached hereto.

Question Presented

Is the purchaser of approximately 29% of the registered equity securities of an issuer, who prior thereto owned no such securities but who within six months after the purchase "voluntarily disposes of" the securities, liable under Section 16(b) of the Securities Exchange Act of 1934, 48 Stat. 896, 15 U.S.C. § 78p(b), to the issuer for all short-term profits realized?

Statement of the Case

Petitioner Allis-Chalmers is a Delaware corporation whose common stock was at all relevant times registered pursuant to the provisions of Section 12 of the Securities Exchange Act of 1934 (the "1934 Act"), 15 U.S.C. § 78 l.

Respondent Gulf & Western Industries, Inc. ("Gulf & Western"), also a Delaware corporation, is a conglomerate which "had bought and sold controlling interests in a number of corporations" prior to its initial purchase of Allis-Chalmers stock. 2a n.1.

In May 1968 Gulf & Western was interested in acquiring a substantial portion of the outstanding common stock of Allis-Chalmers. Respondent's chairman, Mr. Bludhorn, and president, Mr. Judelson, notified the chairman of Allis-Chalmers, Mr. Stevenson, that respondent was considering acquiring stock in petitioner by means of an exchange, and the next day informed petitioner that Gulf & Western would seek to effect the purchase of 3,000,000 shares of Allis-Chalmers stock by means of an exchange offer.

On July 1, 1968 respondent formally offered to purchase 3,000,000 shares of Allis-Chalmers common stock for a package of cash, subordinated debentures and warrants. These 3,000,000 shares represented approximately 29% of the then outstanding Allis-Chalmers common stock. The exchange offer was fully subscribed to on July 19, 1968, and respondent's shareholders approved the offer on July 29, 1968. Prior to its purchase of these 3,000,000 shares of Allis-Chalmers, Gulf & Western owned none of petitioner's common stock.

Subsequent to the purchase of this 29% block of Allis-Chalmers common stock, respondent entered into an agreement in August 1968 with Oppenheimer Fund, Inc. ("Oppenheimer") whereby respondent would acquire an additional 248,000 shares of Allis-Chalmers common stock held by Oppenheimer. Gulf & Western's purchase of this block of stock occurred on September 30, 1968.

In the period subsequent to its agreement to acquire the second block of Allis-Chalmers common stock, respondent underwent a change of heart as to the attractiveness of owning 3,248,000 shares of Allis-Chalmers stock. The Court of Appeals wrote:

> "On September 13, 1968 Allis-Chalmers chairman Stevenson had on his own initiative met with Bludhorn and Judelson of Gulf & Western and had, according to his recollection at trial, told them that things did not look good for Allis-Chalmers. He refused to quantify the bad news for the Gulf & Western representatives in response to their specific questions, but he clearly disclosed to them his personal negative evaluation of the situation at Allis-Chalmers. Stevenson's notes for this meeting reflected his belief at that time that the Gulf & Western people were 'getting nervous' about their block of stock in Allis-Chalmers. At trial, Stevenson testified that he 'had the feeling right then [at the September 13, 1968 meeting] that they were thinking about disposing of it." 4a n.4.

On the very day of its purchase of the block of Allis-Chalmers stock from Oppenheimer, Gulf & Western commenced negotiations with White Consolidated Industries, Inc. ("White") for the sale to White of the entire block of 3,248,000 Allis-Chalmers shares owned by respondent.

On October 31, 1968 respondent and White reached agreement, and on December 6, 1968 Gulf & Western sold its entire block of 3,248,000 shares of Allis-Chalmers stock to White. Therefore, within a period of less than six months, Gulf & Western had first purchased in two large blocks and then, after apparently "getting nervous" over the prospects of Allis-Chalmers, sold in a single transaction 3,248,000 shares of Allis-Chalmers registered common stock.

The Decision of the District Court

On January 6, 1969 petitioner commenced suit against Gulf & Western, pursuant to Section 27 of the 1934 Act, to recover pursuant to Section 16(b) the short-swing profits that Gulf & Western realized on the two purchases and single sale within less than six months of 3,248,000 shares of Allis-Chalmers common stock. A non-jury trial resulted in a judgment against Gulf & Western in the amount of $1,135,838, the amount the District Court calculated to have been Gulf & Western's profits on the two purchases and single sale of all 3,248,000 shares of Allis-Chalmers stock. The District Court held that respondent was a "beneficial owner" within the meaning of Section 16(b) when it made its initial exchange offer purchase of approximately 29% of petitioner's common stock, and, in accord with rulings of the Courts of Appeals for the Second and Eighth Circuits and decisions of this Court, construed the proviso of Section 16(b) exempting "any transaction where such beneficial owner was not such both at the time of purchase and sale" as not applying to Gulf & Western's initial purchase of more than 10% of the listed equity securities of Allis-Chalmers.

The Decision of the Court of Appeals

Both petitioner and respondent appealed to the Court of Appeals for the Seventh Circuit. Prior to the decision of the Court of Appeals for the Ninth Circuit in *Provident Securities Co.* v. *Foremost-McKesson, Inc.*, 506 F.2d 601 (9th Cir. 1974), *cert. granted,* 420 U.S. 923 (1975), Gulf & Western principally argued that Section 16(b) did not apply to the purchases and sale involved in this case, relying on the decision of this Court in *Kern County Land Co.* v. *Occidental Petroleum Corp.*, 411 U.S. 582 (1973).

After the decision of the Ninth Circuit, Gulf & Western contended that it was not liable under Section 16(b) for profits realized on the sale of the initial 3,000,000 shares of Allis-Chalmers stock it purchased in July and sold in December 1968. Gulf & Western's position was that because it owned no such stock prior to its exchange offer purchase, it was not a beneficial owner "both at the time of the purchase and sale" and therefore was exempt under the proviso of Section 16(b) from liability for the short-swing profits that it had realized.

The Court of Appeals for the Seventh Circuit relied heavily on the decision of the Ninth Circuit in *Provident Securities Co.* v. *Foremost-McKesson, Inc.*, 506 F.2d 601 (9th Cir. 1974), *cert. granted,* 420 U.S. 923 (1975), as well as the language of a Senate bill that was left aside in favor of the present Section 16(b). The Seventh Circuit held that Section 16(b) only applies to "beneficial owners" who, after already owning 10% of the securities of an issuer, thereafter realize profits from the purchase and sale within six months of additional shares. The Court, as noted above, candidly acknowledged "that a contrary view

has been taken in the Second and Eighth Circuits" and that "a conflict between circuits exists." 6a n.5.

Respondent further argued to the Seventh Circuit that its second purchase of stock (from Oppenheimer) on September 30, 1968 was such an integral part of the original exchange offer that the test utilized by this Court in *Kern County Land Co.* v. *Occidental Petroleum Corp.*, 411 U.S. 582 (1973), must be applied and that respondent should not be liable for the short-swing profits realized from the purchase and sale of that block of stock. The Court of Appeals rejected this contention, holding that the Oppenheimer transaction was neither "an unorthodox transaction" nor devoid of the possibility of speculative abuse.

Petitioner Allis-Chalmers appealed to the Seventh Circuit on the ground that the District Court had improperly calculated the extent of respondent's short-swing profits. The Court of Appeals agreed, holding after detailed analysis of the evidence that respondent had in fact realized profits of $2,465,680.47 from the purchase from Oppenheimer and sale to White of the block of 248,000 shares of Allis-Chalmers stock.

Reasons for Granting a Writ of Certiorari

A writ of certiorari should issue to review the judgment of the Court of Appeals for the Seventh Circuit because that court has rendered a decision which conflicts with decisions of the Courts of Appeals for the Second and Eighth Circuits. The importance of this federal question, concerning the applicability or inapplicability of this remedial statute to far from unusual circumstances, cannot be contested in view of the grant of a writ of certiorari in

Foremost-McKesson, Inc. v. *Provident Securities, Inc.*, 420 U.S. 923 (1975).

Prior to the decision of the Court of Appeals herein, both Allis-Chalmers and Gulf & Western moved for and were granted leave by this Court to file briefs *amici curiae* in support, respectively, of petitioner's petition for certiorari and respondent's opposition thereto in *Foremost-McKesson, Inc.* v. *Provident Securities Co.*, Docket No. 74-742. While the question presented by the instant petition is likely to be decided in *Foremost-McKesson*, that case may involve the resolution of additional questions not here presented. Allis-Chalmers' motion for leave to file an *amicus* brief is included herein as Appendix C.

The narrow question presented here is the construction of the phrase "at the time of" in the exemption for "beneficial owners" provided in Section 16(b). Simply stated, the question is whether a person must first own 10% of the securities of an issuer and then purchase and sell additional shares within six months before short-swing profits must be disgorged. The plain statement of this discrete question completely conceals, however, the profoundly broad practical impact that its resolution encompasses. Does this "prophylactic" statute preclude an issuer from recovering approximately $10,000,000 of short-swing profits realized from the purchase and sale within six months of 29% of the listed securities for the calculated or fortuitous reason that the beneficial owner purchased all such stock in one transaction?

If there is any concern as to what Congress did mean when it limited the coverage of the statute to situations where the beneficial owner is a 10% owner "both at the time of the purchase and sale, or the sale and purchase", Allis-Chalmers suggests that this Court supplied the answer in

Reliance Electric Co. v. *Emerson Electric Co.,* 404 U.S. 418, 423 n.3 (1972). There this Court cites with approval 2 L. Loss, SECURITIES REGULATION 1060 (2d ed., 1961) with respect to step sales. Professor Loss' full text covers both step purchases and step sales.

> "A substantial 'out' nevertheless remains for the 10 percent holder: If a person who is not an insider wants to acquire up to, say, 15 percent, he should buy up to just under 10 percent in one transaction (which will be exempted even under the court's construction [in *Stella* v. *Graham-Paige Motors Corp., infra*]) and then buy the remaining 5-plus percent in a separate transaction. Conversely, a person who owns 15 percent and wants to sell down to 5 percent should sell 5-plus percent in one transaction and then, after he becomes a holder of slightly less than 10 percent, sell out the remainder."

As recognized by the Court of Appeals in the instant case, the Second Circuit consistently has held for 19 years that "at the time of" does not mean "prior to" but "simultaneously with", and that a person is a "beneficial owner" "at the time of" the purchase if more than 10% of a class of registered equity securities are purchased. This construction was first applied in *Stella* v. *Graham-Paige Motors Corp.,* 104 F.Supp. 957 (S.D.N.Y. 1952), *aff'd on this point,* 232 F.2d 299 (2d Cir.), *cert. denied,* 352 U.S. 831 (1956). To construe "at the time of" as meaning "prior to" would permit exactly the type of "in and out" profit-taking Section 16(b) was intended to prevent and that has occurred in this case.

The reasons favoring such a construction of Section 16(b) obviously promote the purpose of the 1934 Act. As

stated by the Chief Justice in *Adler* v. *Klawans,* 267 F.2d 840 (2d Cir. 1959):

> "Most recently in Stella v. Graham-Paige Motors Corp., supra, this court gave approval to the District Court's holding that the purchase which makes a person a 10% beneficial owner may be included notwithstanding the express proviso. All three of these cases underscored, either expressly or impliedly, Judge Clark's statement in the Smolowe case that:
>
> > 'The statute is broadly remedial. Cf. Wright v. Securities and Exchange Commission, 2 Cir., 112 F.2d 89. Recovery runs not to the stockholder, but to the corporation. We must suppose that the statute was intended to be thoroughgoing, to squeeze all possible profits out of stock transactions, and thus to establish a standard so high as to prevent any conflict between the selfish interest of a fiduciary officer, director, or stockholder and the faithful performance of his duty.'" 267 F.2d at 846 (footnote omitted).

The Second Circuit has consistently followed this construction of the phrase "at the time of". *Perine* v. *William Norton & Co.,* 509 F.2d 114, 118 (2d Cir. 1974); *Newmark* v. *RKO General, Inc.,* 425 F.2d 348, 355-56 (2d Cir.), *cert. denied,* 400 U.S. 854 (1970).

The holding of *Stella* was adopted by the Eighth Circuit in *Emerson Electric Co.* v. *Reliance Electric Co.,* 434 F.2d 918 (8th Cir. 1970), *aff'd on other grounds,* 404 U.S. 418 (1972). The Court of Appeals there observed that:

> "[a]ny other view [of the meaning of the phrase 'at the time of'] has the weakness of impracticability of appli-

> cation of the statute, a result we should not lightly attribute to a Congress striving to prevent what it considered to be highly undesirable speculations by certain security owners who are in position to obtain or to be exposed to that kind of inside information lending itself to speculative use to the possible detriment of the public." 434 F.2d at 924.

Despite this Court's observation that "the legislative history [of Section 16(b)] affords no explanation of the purpose of the proviso", *Reliance Electric Co.* v. *Emerson Electric Co.*, 404 U.S. 418, 424 (1972), the Ninth Circuit in *Provident Securities Co.* v. *Foremost-McKesson, Inc.*, 506 F.2d 601 (9th Cir. 1974), *cert. granted*, 420 U.S. 923 (1975), purported to find legislative history supporting a construction of "at the time of" as meaning "prior to". As set forth fully in Allis-Chalmers' brief as *amicus curiae* in support of Foremost-McKesson, Inc.'s petition for a writ of certiorari, reproduced in Appendix C hereto, the Ninth Circuit reached this conclusion on the basis of language contained in a Senate bill which was never enacted. As shown in Allis-Chalmers' *amicus* brief, the legislative history of the House bill, which was the lineal predecessor of Section 16(b), supports petitioner's position. The House bill was introduced almost a month *after* the hearings on a Senate bill upon which the Ninth Circuit erroneously relied in reaching its construction of the proviso of Section 16(b). See 87a-92a.

In the present case, the Seventh Circuit stated that it agreed with much of the Ninth Circuit's analysis of the legislative history, thereby perpetuating that Court's erroneous construction of Section 16(b). 15a-19a. Allis-Chalmers submits that, to the extent relevant legislative

history exists, it supports the position of the Second and Eighth Circuits that Congress intended to bar an insider from retaining the type of short-swing profits realized here by Gulf & Western.

As is obvious from the facts of this case, Gulf & Western's reliance on *Kern County Land Co.* v. *Occidental Petroleum Corp.*, 411 U.S. 582 (1973), is entirely misplaced. That the decision therein, involving an involuntary, forced disposition of the shares as part of a corporate reorganization, is inapposite requires no extended comment. Even the Court of Appeals for the Seventh Circuit, in the present case pointed out that Gulf & Western

> "voluntarily disposed of the [Allis-Chalmers] shares within six months, *after* obtaining an indication from Allis-Chalmers' chairman that the future of that company did not look any too bright. The possibility clearly existed, therefore, that Gulf & Western's early disposition of its Allis-Chalmers shares was an attempt to avoid the effect of the predicted weakening of Allis-Chalmers' common stock, a prediction gained as an insider of that company." 24a (emphasis in original).

This Court stated in *Reliance Electric Co.* v. *Emerson Electric Co.*, 404 U.S. 418, 424 (1972):

> "To be sure, where alternative constructions of the terms of § 16(b) are possible, those terms are to be given the construction that best serves the congressional purpose of curbing short-swing speculation by corporate insiders". (Footnote omitted.)

Clearly the situation in which a corporation makes an initial purchase of almost 29% of the common stock of

another and sells the entire block within six months at a handsome profit constitutes exactly the opportunity for short-term speculation Congress intended to prevent by enacting Section 16(b). The applicability of Section 16(b) would be severely if not fatally curtailed with respect to a variety of situations in which Congress attempted by means of a flat rule to prevent the *possibility* of "the unfair use of information". The construction of Section 16(b) adopted by the Courts of Appeals for the Seventh and Ninth Circuits not only does plain violence to the Congressional purpose underlying Section 16(b) but cannot logically be found in the statute or gleaned from the legislative history. The conflict among the Courts of Appeals over the construction of a statute prescribing important national policy must, and can only be, resolved by this Court.

CONCLUSION

For the reasons set forth above, petitioner Allis-Chalmers Manufacturing Company prays that a writ of certiorari issue to review the judgment of the Court of Appeals for the Seventh Circuit, or, in the alternative, that this Court withhold action on this petition pending the decision of this Court in *Foremost-McKesson, Inc.* v. *Provident Securities Co.,* Docket No. 74-742, and thereafter dispose of this petition in accordance with any decision therein which may control the issue presented by this petition.

Dated: October 16, 1975

Respectfully submitted,

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APPENDICES

APPENDIX A

Opinion of the United States Court of Appeals for the Seventh Circuit

In the

United States Court of Appeals

For the Seventh Circuit

Nos. 74-1266 and 74-1267

ALLIS-CHALMERS MANUFACTURING COMPANY,
a Delaware Corporation,

Plaintiff-Appellant,

v.

GULF & WESTERN INDUSTRIES, INC.,
a Delaware Corporation,

Defendant-Appellee.

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division—
No. 70 C 513
JAMES B. PARSONS, *Judge.*

ARGUED JANUARY 14, 1975 — DECIDED SEPTEMBER 29, 1975

Before CLARK, *Associate Justice* (*Retired*),* SWYGERT and PELL, *Circuit Judges.*

SWYGERT, *Circuit Judge.* This appeal presents several issues concerning the proper construction of section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b). The section, which seeks to prevent misuse of internal corporate information, requires certain statutorily defined corporate insiders to remit to their corporation any profits realized as a result of any transaction consisting of a purchase and subsequent sale, or sale and

* The Honorable Tom C. Clark, Associate Justice (Retired) of the Supreme Court of the United States, is sitting by designation.

repurchase, which is completed within six months. Included among the insiders covered by the section are owners of more than ten percent of any class of equity security registered under the provisions of section 12 of the Act, 15 U.S.C. § 78(*l*). In this case we must determine whether the section applies to an initial purchase of more than ten percent of a covered security by one who was an outsider until that purchase was consummated. In addition we must decide whether the facts in this case so completely preclude the possibility of misuse of inside information that application of the section to this type of transaction could serve no purpose. Finally, questions exist as to the proper method of determining the profits realized where a violation is found.

In May of 1968, Gulf & Western Industries, Inc.[1] began actively to contemplate the acquisition of a substantial interest in Allis-Chalmers Manufacturing Company.[2] In this connection, Charles G. Bludhorn, chairman of the board of Gulf & Western, and David N. Judelson, its president, contacted Robert S. Stevenson, the chairman of the board at Allis-Chalmers. First contact was made on May 6, 1968. Bludhorn and Judelson indicated that Gulf & Western was considering an exchange offer and that they would keep Stevenson advised as these plans developed. On the following day Stevenson was informed that an exchange offer would immediately be announced by Gulf & Western, pursuant to which Gulf & Western would seek to acquire 3,000,000 shares of Allis-Chalmers common stock in return for a per share consideration of $11.50 cash plus $12.50 principal amount of a Gulf & Western six percent subordinated debenture due in 1988 plus 9/10 of a ten-year registered Gulf & Western warrant to purchase Gulf & Western common stock at fifty-five dollars per share.

The offer was formally made through a prospectus dated July 1, 1968. By its terms, Gulf & Western agreed

[1] Gulf & Western is a Delaware corporation engaged in diversified pursuits including manufacturing, distribution, mining, agricultural, and other operations. The record indicates that prior to the transaction here involved, Gulf had bought and sold controlling interests in a number of corporations.

[2] Allis-Chalmers is a Delaware corporation whose common stock is, and was at all relevant times, registered on the New York Stock Exchange pursuant to 15 U.S.C. § 78(*l*).

to accept Allis-Chalmers shares tendered prior to July 19, 1968 on a pro-rata basis up to a total of 3,000,000 shares accepted. If less than 3,000,000 shares were tendered by July 19th, then Gulf & Western further agreed to accept additional shares thereafter on a "first-come, first-served basis," up to the 3,000,000 limit. The offer was subject to the approval of the Gulf & Western stockholders at a meeting to be held on July 29, 1968, and was to expire in any event on July 30, 1968 unless extended prior thereto by Gulf & Western. All tenders of Allis-Chalmers stock were to be irrevocable by the tendering party. The offer was fully subscribed by July 19, 1968 so that no shares tendered thereafter could be accepted under the terms of the offer, no extension having been made by Gulf & Western. The shareholders of Gulf & Western approved the offer on July 29, 1968.

After this initial acquisition, on August 28, 1968, Gulf & Western entered into an agreement with Oppenheimer Fund, Inc. whereby they would acquire 248,000 additional shares of Allis-Chalmers stock owned by Oppenheimer in return for 496,000 warrants for the purchase of Gulf & Western common stock. The closing date for the agreed exchange was to be September 30, 1968. The warrants were not to be registered initially, but according to the agreement Gulf & Western was to file a registration statement for these warrants and for the shares of Gulf & Western stock to be issued thereunder on or before April 30, 1969. In addition, Gulf & Western agreed that if the registration statement became effective later than December 31, 1968, it would guarantee an average per warrant price of $13.50 for any warrants sold by Oppenheimer within ninety days after actual registration. This was to be accomplished either by a payment from Gulf & Western of the difference between the average sale price and $13.50, or by Gulf & Western supplying a purchaser willing to take the warrants at the guarantee price or better.[3] This exchange was carried out, the closing being held on September 30, 1968. The registration statement

[3] The agreement provided that if the guarantee were invoked Gulf & Western would have three business days during which to find a purchaser willing to pay a higher price than the price at which Oppenheimer intended to sell the warrants. If no such purchaser was found, then Oppenheimer would be free to sell and to seek a cash payment under the guarantee for all shares sold during the ninety-day period.

did not become effective until after December 31, 1968, and after an agreed extension of the guarantee period, Oppenheimer in fact sold 487,500 warrants subject to the guarantee and obtained a payment thereunder from Gulf & Western in the amount of $2,154,437.50 on June 5, 1969.

One month after the Oppenheimer acquisition, on October 31, 1968, Gulf & Western reached an agreement with White Consolidated Industries, Inc. whereby White would purchase Gulf & Western's entire holding in Allis-Chalmers, which at this point consisted of 3,248,000 shares of Allis-Chalmers common stock. This agreement was the result of negotiations between Gulf & Western and White which had commenced with a meeting between Mr. Bludhorn and White representatives on September 30, 1968, the very day that the Oppenheimer exchange was closed.[4] The White acquisition was consummated on December 6, 1968. Gulf & Western received in return for its Allis-Chalmers stock 250,000 unregistered shares of White common stock plus $20,000,000 in cash plus a 180-day promissory note at 8.5 percent interest in the face amount of $93,680,000. The promissory note was given in lieu of cash pursuant to a payment option in the October 31, 1968 agreement with Gulf & Western and was in fact redeemed with interest by White on March 20, 1969.

On January 6, 1969 this action was commenced by Allis-Chalmers in the Eastern District of Wisconsin. On motion of Gulf & Western the cause was transferred to the Northern District of Illinois. 309 F. Supp. 75 (E.D. Wis. 1970). A trial was conducted without a jury, and Gulf & Western was held liable to Allis-Chalmers for all profits realized as a result of the purchase and sale of all 3,248,000 shares of Allis-Chalmers stock. Profits were found by the district judge in the amount of $1,135,838.00 and judgment was entered against Gulf & Western and in

[4] On September 13, 1968 Allis-Chalmers chairman Stevenson had on his own initative met with Bludhorn and Judelson of Gulf & Western and had, according to his recollection at trial, told them that things did not look good for Allis-Chalmers. He refused to quantify the bad news for the Gulf & Western representatives in response to their specific questions, but he clearly disclosed to them his personal negative evaluation of the situation at Allis-Chalmers. Stevenson's notes for this meeting reflected his belief at that time that the Gulf & Western people were "getting nervous" about their block of stock in Allis-Chalmers. At trial, Stevenson testified that he "had the feeling right then [at the September 13, 1968 meeting] that they were thinking about disposing of it."

favor of Allis-Chalmers in this amount. 372 F.Supp 570 (N.D. Ill. 1974). Both parties appeal from this judgment.

I

The first question we must resolve is whether the transaction consisting of initial acquisition of 3,000,000 shares of Allis-Chalmers common stock and its subsequent sale by Gulf & Western falls within that class of transactions subject to section 16(b) of the Securities Exchange Act. That section provides in relevant part:

> For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months . . . shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. . . . This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection.

The term "beneficial owner" is defined in section 16(a) and includes "[e]very person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity security . . . registered pursuant to [15 U.S.C. § 78(*l*)]."

There is nothing in the record to indicate that prior to the July 1968 exchange offer Gulf & Western had any legally significant relationship with Allis-Chalmers. Only when the July acquisition was completed did Gulf & Western become a "beneficial owner" within the meaning of section 16(b). Thus, there is no possibility under the facts of this case that Gulf & Western could have made "unfair use of information . . . obtained . . . by reason of [its]

relationship to [Allis-Chalmers]" until after the initial acquisition. The precise question is therefore whether section 16(b) applies to a purchase/sale short-swing transaction where the decision to initiate the transaction (i.e., purchase the stock) could not have been premised on use of information obtained through a section 16(a) insider relationship with the issuing company. We are mindful, however, that the intent and purpose of legislation "must [be] glean[ed] from the statute as a whole rather than from isolated parts." *Adler* v. *Klawans*, 267 F.2d 840, 844 (2d Cir. 1959). We therefore have examined the language of section 16(b) in its totality. This examination, and a consideration of the legislative development of section 16(b) convinces us that the statute was never intended to reach such a transaction.

A

We realize that a contrary view has been taken in the Second and Eighth Circuits. On the other hand, the Ninth Circuit has recently decided this issue consistent with our interpretation, based on a thorough review of the legislative history of section 16(b).[5] A discussion of these conflicting precedents is pertinent.

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[5] Since Part I of this opinion adopts a position on an issue as to which a conflict between circuits exists, this opinion has been circulated to all the active judges of the court. A majority of the active judges have not requested a rehearing *en banc*, and no rehearing will be held, pursuant to Internal Rule 2.

Judge Philip W. Tone has disqualified himself from any consideration of this case and has asked that this fact be noted.

Chief Judge Thomas E. Fairchild and Judge Walter J. Cummings have asked that their votes in favor of rehearing be noted.

Judge John Paul Stevens has asked that his separate views be noted:

STEVENS, Circuit Judge. Although I voted against a rehearing en banc because I agree with Judge Swygert's basic conclusion that the fact of critical importance is the controlling person's presumed access to inside information at the time of his decision either to buy or to sell, I do not agree with his reading of the clause making § 16(b) inapplicable to "any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved. . . ." I think the word "both" refers to both times, that is, the time of purchase and the time of sale, rather than to both a purchase-sale and a sale-purchase. The word "or" in the clause, as well as the Supreme Court's holding in *Reliance Electric Co.* v. *Emerson Electric Co.*, 404 U.S. 418, require this reading. This reading is not contrary to Judge Swygert's holding because Gulf & Western was a controlling person both at the time of its purchase of the 348,000 shares and also at the time of its sale of those shares.

In *Stella* v. *Graham-Paige Motors Corp.*, 104 F. Supp. 957 (S.D.N.Y. 1952), *recognized as law of the case*, 132 F.Supp. 100 (S.D.N.Y. 1955), *aff'd in part, remanded in part on other grounds*, 232 F.2d 299 (2d Cir. 1956), *cert. denied*, 352 U.S. 831 (1956), District Judge Samuel H. Kaufman was confronted with the following facts. In 1945 the Kaiser-Frazer Corporation was organized. Its capital structure consisted of 500,000 shares of common stock, half of which were owned by Graham-Paige Motors Corporation. In that same year Kaiser-Frazer issued 1,700,000 new shares of common stock, bringing the proportional Graham-Paige interest down from fifty percent to 11.34 percent. On January 23, 1946 Kaizer-Frazer issued 1,800,000 additional shares. This cut the Graham-Paige interest down to 6.25 percent, or well below the level constituting section 16 (b) beneficial ownership. About a year later, on February 10, 1947, Graham-Paige purchased 750,000 additional shares of Kaiser-Frazer stock. With the completion of this acquisition, Graham-Paige was once again a beneficial owner, with holdings constituting twenty-one percent of Kaizer-Frazer stock. One day less than six months later, on August 9, 1947 Graham-Paige sold 155,000 shares of Kaiser-Frazer common stock. A stockholder of Kaiser-Frazer brought suit on behalf of that corporation to recover any profit from that sale.

Judge Kaufman held that the purchase on February 10, 1947 by which defendant Graham-Paige resumed its beneficial owner status could be matched with the sale of August 9, 1947 to constitute a section 16 (b) transaction even though Graham-Paige was not a beneficial owner immediately prior to the February purchase. He based this determination on an "ambiguity" in the exemption language contained in section 16 (b). That language reads:

> This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved. . . .

Judge Kaufman saw two reasonable interpretations of the words "at the time of" as used in this passage. He noted that these words could mean "prior to" as defendant contended, or "simultaneously with" as urged by the

plaintiff and the Securities and Exchange Commission, as *amicus*. Recognizing that the Congressional purpose behind section 16 (b) was "to protect the outside stockholders against at least short-swing speculation by insiders with advance information" 104 F. Supp. at 959 [citations omitted], he adopted the "simultaneously with" construction and held Graham-Paige liable. Judge Kaufman based his holding in part on the fear that the "prior to" interpretation would allow "a person to purchase a large block of stock, sell it out until his ownership was reduced to less than ten percent, and then repeat the process, ad infinitum." *Id.* at 959. This construction was accepted as the law of the case by District Judge Dimock in a subsequent district court opinion and was affirmed without analysis by the Second Circuit, Judge Hinks dissenting. Judge Hinks reasoned in part:

> [T]he basic rationale of the Act was such that only completed swing transactions gave rise to the presumption of unethical use of advance information: if one purchased stock on one day, became a director on the next, and sold some of his stock on the next, any resulting profit was not recoverable by the corporation apparently because a sale alone was thought to be insufficient basis for a drastic presumption that it had been made in violation of a fiduciary duty. In principle, the same rationale is equally applicable to beneficial owners who do not become such until a given purchase is consummated. Under that rationale, the presumption will arise only when both the purchase and the sale were made by one who at the time was a fiduciary.
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> 232 F.2d at 305.

Judge Kaufman's construction continues to be authoritative in the Second Circuit.[6]

In the Eighth Circuit, the *Stella v. Graham-Paige Motors Corporation* construction of section 16 (b) was expressly adopted in *Emerson Electric Co. v. Reliance Electric Co.*, 434 F.2d 918 (8th Cir. 1970), *aff'd*, 404 U.S. 418 (1972). The Supreme Court's affirmance in *Emerson*, however,

[6] *Newmark v. RKO General, Inc.*, 425 F.2d 348, 355-56 (2d Cir. 1970); *Perine v. William Norton & Co., Inc.*, 509 F.2d 114, 118 (2d Cir. 1974).

never reached this question. 404 U.S. at 421.[7] Looking then to the Eighth Circuit opinion, we find the following factual situation. Emerson Electric became interested in acquiring Dodge of Mishawaka, Indiana, a small manufacturer of electric transmission equipment. Emerson initiated merger negotiations. Dodge rejected the idea of merger, and Emerson then made a tender offer for Dodge common stock. Through this offer, Emerson acquired 13.2 percent of Dodge common stock. Dodge, however, was at the same time negotiating a defensive merger with Reliance Electric, a competitor of Emerson. A proxy fight ensued, and Reliance was the victor, the proposed defensive merger being approved by the Dodge shareholders. Shortly thereafter Emerson decided to liquidate its position in Dodge prior to final director approval of the Dodge/Reliance merger. Recognizing the possible section 16 (b) problem in doing so within six months of the original acquisition, Emerson liquidated in two steps, the first sale bringing its Dodge holdings down to 9.9 percent and the second sale disposing of this balance. Both steps of the liquidation were carried out within six months of the original acquisition.

In determining that Emerson was liable for the profits gained in the first step of the two-step sale of Dodge stock, the Eighth Circuit reasoned that the phrase "at the time of" was ambiguous. The court saw three possible meanings attributable to the phrase in the context of section 16 (b): (1) "immediately before," (2) "simultaneously with," or (3) "immediately after."[8] Next, the court noted that in its opinion it was "doubtful that Congress intended it to have one of those meanings in every situation." 434 F.2d at 923. This suggestion was necessary to the court's

[7] The Supreme Court concentrated its analysis exclusively on the "second sale" by which Emerson disposed of its remaining 9.96% interest in Dodge stock. Its decision was founded on the fact that this sale was made when Emerson was no longer a "beneficial owner" within the terms of the statute, and on the fact that SEC Rule 16a-10, 17 C.F.R. §240.16a-10, exempts from 16(b) any transaction involving a sale made during a month in which the stockholder never owned more than a 10% interest. *But see* 404 U.S. at 440-41 (Douglas, J. dissenting).

[8] We are unable to see any practical difference between "simultaneously with" and "immediately after" as used in *Emerson*, unless "simultaneously with" merely means *either before or after* depending on which construction best suits the purpose of the statute as perceived by the judge applying it. *See* Note, *Stockholder Acquiring 10%*

decision to follow the *Stella* rationale because the Eighth Circuit recognized the logical anomaly of the *Stella* rule, namely, that if "at the time of" is uniformly construed to mean "simultaneously with" the execution of the purchase or sale, then in every buy/sell transaction in which the sale reduces the defendant's holdings to *below* ten percent of the issuing corporation, as was the case in the first sale in the *Emerson* liquidation, that sale would call into effect the exemption provision. That is, "at the time of" such a sale (the instant it became effective) the defendant would no longer be a beneficial owner. Faced with this legal puzzle, the *Emerson* court was forced to define "simultaneously with" to mean *both* "before" *and* "after"' depending on which end of the short-swing transaction is being analyzed: "a 10 percent stockholder need only be such simultaneously with each transaction; that is, just after a purchase or just before a sale." 434 F.2d at 923 (footnote omitted).[9]

In adopting this construction the court recognized that "the problem of interpretation is difficult and not free of all doubt." Nonetheless, the court was persuaded that the Congressional intent to stop the possible use of inside information by directors, officers and beneficial owners in connection with short-swing transactions demanded this construction to avoid "impracticability of application." Illustrative of the problems perceived by the *Emerson*

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[8] (Continued)

Ownership on Purchase Held Liable for Profits Under Section 16(b) *of the Securities Exchange Act*, 57 Colum. L. Rev. 287, 289 (1957) (cited by the Eighth Circuit in *Emerson*). In this light, it is interesting to note the district court's formulation of the issue, and its answer, in the *Emerson* litigation:

> [W]e are convinced that "at the time of purchase" includes the time "simultaneously with" the purchase, so that a shareholder becomes subject to the provisions of Section 16(b) immediately upon (that is, at the very moment of) his acquisition of more than 10 per cent of the corporation's stock." *Emerson Electric Co.* v. *Reliance Electric Co.*, 306 F. Supp. 588, 589 (E.D.Mo. 1969) (original emphasis).

The use of the verb "includes" would imply that the district judge perceived the phrase "at the time of" to cover both "prior to" and "simultaneously with," and it is clear from the result reached that his conception of "simultaneously with" is virtually indistinguishable from "immediately after."

[9] The quoted words were used by the Eighth Circuit to describe the holding of the Second Circuit in *Stella*. In deciding the case before it, the Eighth Circuit avoided restating this inconsistency by focusing narrowly on the facts presented, but it is clear that the court did adopt this dual-meaning construction of "at the time of."

court was the possibility that one might purchase a block of stock as large as fifty-one percent and then sell within six months with section 16 (b) impunity even though *after* the purchase of this block such an investor would be in a position to obtain inside information and exercise influence over corporate transactions.

The Ninth Circuit, in the recent case of *Provident Securities Co.* v. *Foremost-McKesson, Inc.*, 506 F.2d 601 (9th Cir. 1974), *cert. granted*, 42 U.S.L.W. 5446 (U.S. Feb. 18, 1975), rejected the application of section 16 (b) to an initial ten percent acquisition. In doing so, the court expressly recognized the contrary decisions of the Second and Eighth Circuits, but declined to follow them. This decision was based in part on an analysis of dicta contained in the Supreme Court's opinions in *Reliance Electric Co.* v. *Emerson Electric Co.*, 404 U.S. 418 (1972) and *Kern County Land Co.* v. *Occidental Petroleum Corp.*, 411 U.S. 582 (1973), and in part on a review of the legislative history of section 16 (b).

The court in *Provident* began its discussion of the initial purchase issue by noting that in *Reliance* the Supreme Court placed great emphasis on the requirement that a section 16 (b) beneficial owner/defendant be such a beneficial owner "both at the time of purchase and sale. . . ." 506 F.2d at 608. Turning to the subsequent *Kern* opinion, the court quoted the initial formulation of issues by the Supreme Court in that case:

> Unquestionably, one or more statutory purchases occur when one company, seeking to gain control of another, acquires more than 10% of the stock of the latter through a tender offer made to its shareholders. But is it a § 16 (b) "sale" when the target of the tender offer defends itself by merging into a third company and the tender offeror then exchanges his stock for the stock of the surviving company and also grants an option to purchase the latter stock that is not exercisable within the statutory six-month period?
>
> 411 U.S. at 584.

Recognizing the ambiguity in the first sentence of this passage, the *Provident* court opined that the reference to "one or more statutory purchases" may have indicated that statutory purchases occur only *after* the purchaser has

acquired an initial ten percent.[10] The court pointed out that this interpretation would be consistent with the following additional language in *Kern*:

> If its takeover efforts failed, it is argued, Occidental knew it could sell its stock to the target company's merger partner at a substantial profit. Calculations of this sort, however, *whether speculative or not* and whether fair or unfair to other stockholders or to Old Kern, *do not represent the kind of speculative abuse at which the statute is aimed, for they could not have been based on inside information obtained from substantial stockholdings that did not yet exist.* Accepting both that Occidental made this very prediction and that it would recurringly be an accurate forecast in tender-offer situations, we nevertheless fail to perceive how the fruition of such anticipated events would require, or in any way depend upon, the receipt and use of inside information. If there are evils to be redressed by way of deterring those who would make tender offers, § 16 (b) does not appear to us to have been designed for this task. 411 U.S. at 597 (footnote omitted).[11]

Turning to the legislative history of section 16 (b), the *Provident* court noted that early drafts of the section focused on the intention of a corporate insider in making a purchase of his company's stock, not to change his investment relationship to the corporation, but to capitalize on inside information by entering into a short-swing purchase/sale transaction in an upward market. According to the court in *Provident*, part of the design of this scheme would be for the insider to come out of the transaction with "exactly the same interest in the corporation as he owned before he began his speculative venture." 506 F.2d at 609. These drafts, however, did not cover the converse situation: the sale by an insider of his corporation's stock

[10] The original offer in *Kern* was made on a first-come, first-served basis, so in all probability a number of the separate purchase transactions involved in the original offer were consummated *after* the particular purchase which put Occidental over the 10% ownership level.

[11] Two additional factors undercut any attempt to characterize *Kern* as an approval of the *Stella* rationale, as suggested by defendants in this case: first, *Stella* was never cited in the *Kern* opinion, and second, the Court specifically noted elsewhere in the opinion that the decision to extend the original offer to encompass an additional 500,000 shares was made *after* the acquisition of a 10% interest by Occidental. 411 U.S. at 584-85, n. 7.

in a downward market with the intent of replacing it at a lower price over a short term. To remedy this omission, the operative language was modified in part. Where the early drafts had read:

> [A]ny profit made by such person on any *transaction* in such a registered security extending over a period of less than six months shall inure to and be recoverable by the issuer. 506 F.2d at 609 (emphasis added),

the later drafts read:

> [A]ny profit realized by [such person] from any *purchase and sale, or any sale and purchase*, of any equity security of such issues . . . within any period of less than six months . . . shall inure to and be recoverable by the issuer. 506 F.2d at 610 (emphasis added).

The *Provident* court saw no indication that this change was intended to alter the original intent of focusing on insider status at the time of entering into the short-swing transaction. Moreover, it reasoned that the presumptions created by the statute necessarily assume this premise:

> The drafters recognized, however, the difficulty of proving that the insider actually intended a short-swing transaction when he made his original decision . . . . In order to ameliorate this difficulty of proving intention or expectation, the section created a statutory presumption that a person with access to inside information who purchases and sells, or sells and repurchases, within a six-month period does so with the intent to speculate rather than to invest. That the drafters intended for the presumption to be conclusive is clear . . . .
>
> Since the presumption of intention or expectation is conclusive, it is necessary that it be narrowly construed so as to apply only to the class of persons who can reasonably be expected to have access to inside information. The hearings demonstrated that Congress intended that the class not be defined too broadly . . . .
>
> As the Committee testimony indicates, the section also creates a presumption that officers, directors and 10-percent shareholders fall within the class of persons who may reasonably be expected to have access to inside information (statutory insiders). It does not

appear, however, that this presumption (as distinguished from the presumption of intent to speculate) is always conclusive, since the Supreme Court has held that at least in some situations it may be rebutted. *Kern County Land Co.* v. *Occidental Petroleum Corp.*, 411 U.S. 582, 93 S.Ct. 1736, 36 L.Ed.2d 503 (1973).

> Nevertheless, the legislative history demonstrates that the class was not intended to include outsiders....
>
> Since a person who decides to purchase enough stock to increase his holdings to 10 percent of a corporation's outstanding shares is an outsider at the time he makes his investment decision, he does not fall within the class of persons to which the conclusive presumption was intended to apply. He may have made that decision on the basis of inside information, but such inside information could not have been acquired, in the language of the statute, "by reason of his relationship to the issuer," or in the language of the Supreme Court, "from substantial stockholdings that did not yet exist." *Kern County Land Co.*, 411 U.S. at 597. We hold that the initial purchase by which a person increases his holdings to 10 percent of a corporation's outstanding stock is not a section 16 (b) transaction and that the conclusive presumption imputing an intent to speculate does not apply to such a person who sells within six months. The statutory language "at the time of," in order to be consistent with the rationale of the statutory presumption, must be construed to mean prior to the time when the decision to purchase is made. 506 F.2d at 610-14 (footnote omitted).

Finally, the court in *Provident* felt compelled to address another context in which section 16 (b) might be applied. In doing so, it created its own modified version of the Eighth Circuit's dual-meaning theory:

> This construction, however, should not be applied to a transaction that is not an initial purchase but in reality is a repurchase or a closing transaction. It would be inconsistent with the rationale of the presumption and with the legislative history to allow a principal shareholder to sell his holdings below the 10 percent level and then repurchase at a profit within six months. Where a shareholder was within a class of persons who had access to inside information by reason of their relationship to the issuer prior to making his initial decision to speculate, the conclusive presumption should be applied if simultaneously with the conclusion of the closing transaction he is the owner of 10 percent of the issuer's stock. Although this conclusion mandates that the language "at the time of" means *prior to* in the case of an initial transaction and *simultaneously with* in the case of a closing transaction, we do not believe that this "inconsistency" is inconsistent with the rationale of the section. In order for the statutory presumption of intention or expectation to deter speculation rather than to impose an arbitrary hardship on a good faith investor, it must apply only to shareholders who, at the time they make the decision to purchase or to sell, are within the class of persons who can reasonably be expected to have access to inside information by reason of their relationship to the corporation. This conclusion does not provide a consistent construction of the language "at the time of" for both the initial and the closing transactions, but it is consistent with the rationale of section 16 (b)—a consistency that we believe is much more important than the consistency of terms. 506 F.2d at 614-15 (footnote omitted).

B

While we agree with much of the analysis in the Ninth Circuit decision in *Provident*, we are convinced that a fundamental conceptual error, initiated in the *Stella* decision, has survived even the careful analysis in *Provident*. It is our view that the legislative history of section 16 (b) provides ample support for a construction of that section which obviates any necessity, under any circumstances, to attribute to Congress an intent to utilize a chameleonic definition of the simple phrase "at the time of." We adopt this simplified construction with full recognition that section 16 (b) is a remedial statute which has a wholesome purpose. *Emerson Electric, supra*, 434 F.2d at 923 and n. 14. This, of course, begs the real question: what *is* that purpose? Our review of the history of the statute convinces us that in enacting section 16 (b) Congress had in mind a specific type of two-part transaction consisting either of a purchase and subsequent sale, or a sale and subsequent repurchase, and did not intend section 16 (b)

to apply to every *separate* purchase or sale as to which some use of inside information is a theoretical possibility.

As Judge Wallace pointed out in *Provident*, the early draft of section 16 (b) did not address the problem of a sale/purchase insider scheme. This apparently was an oversight. The language of the early draft is instructive, however, since it makes clear that Congress originally treated the purchase/sale procedure as a conceptual unit:

> (b) It shall be unlawful for any [beneficial owner]
>
> (1) To purchase any such registered security with the intention or expectation of selling the same security within six months; and any profit made by such person *on any transaction in such a registered security extending over a period of less than six months* shall inure to and be recoverable by the issuer, irrespective of any intention or expectation on his part in entering into such *transaction* of holding the security purchased for a period exceeding six months. *Hearings on S. Res. 56 and S. Res. 97, Before the Senate Comm. on Banking & Currency*, 73d Cong., 1st Sess., Pt. 15, at 6430 (1934) (emphasis added).

As used in the initial draft, the term "transaction" obviously included both purchase and sale. The critical point for measuring insider status (*i.e.*, beneficial ownership) was *prior* to the opening purchase of stock. Thus the section focused on purchases made "with the intention or expectation of selling" within six months, but obviated the need for proof of such intention or expectation "in entering into such transaction." Given the fact that the section was aimed at preventing speculation based on abuse of inside information, the section must have contemplated a *pre-existing* beneficial interest: unless the opening purchase was motivated by an insider's anticipation of an upward market, the full purchase/sale transaction could hardly be characterized as "speculative" from the standpoint of insider abuse. *Kern County Land Co.* v. *Occidental Petroleum Corp.*, 411 U.S. at 597.

When the section was revised to include a sale/repurchase transaction, the term "transaction" was replaced at one point with words describing the two types of insider schemes to be covered by section 16 (b):

> (b) For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him *from any purchase and sale, or any sale and purchase*, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months . . . .
>
> (emphasis added).

Nothing in this portion of the restricted version would indicate that Congress had abandoned the unitary "transaction" concept. Moreover, retention of specific language obviating the need for independent proof of the insider's intention "in entering into such transaction" would indicate that Congress still meant to focus on insider status "prior to" the unitary transaction in question and not "simultaneous with" the initial step in that transaction, as suggested in *Stella* and later cases.

This construction offers a simple method of determining the application of section 16 (b) to a given situation. The question is whether one in a position of presumed access to inside information, that is, a director, officer, or a 10 percent stockholder of a corporation, combined a purchase and a sale of his company's stock, in any order, within a period of six months, thereby producing a profit. If the answer to this question is yes, the profit attributable to the short-swing transaction must be returned to the corporation. The logic of this test is clear: the position of director, officer, or beneficial owner results in a presumption of access to inside information, and the short-term nature of the transaction results in a presumption that this information motivated a coordinated short-term turn-over. Difficulties in proving either access or motivation justify the conclusiveness of these presumptions.

The final question is whether the language of the exemption clause precludes our construction of section 16(b). The exemption clause provides in pertinent part:

> This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved . . . .

Having in mind the purpose of the section as first drafted, there is little reason to believe that this clause was meant to *extend* coverage to situations where the purchase/sale or sale/repurchase could not have been motivated at the beginning of the transaction by inside information. The language of the clause is that of limitation and not of expansion.

More difficult is the question of whether the exemption clause requires a determination of beneficial ownership relative to each component of a short-swing transaction, that is, relative to the purchase and to the sale, regardless of which comes first.[12] The use of the word "both" is confusing in this regard. It is possible to read the word to refer to the separate components of the two types of short-swing transactions; this has been the prevailing view. It is also possible to read this word to refer to the two types of transactions *as transactions*. Neither construction is absolutely apparent. If Congress had intended the first construction it could easily have said "both at the time of the purchase and at the time of the sale." Similarly, if Congress had intended the second construction it could have said "both at the time of the purchase

[12] We are aware that the Supreme Court's opinion in *Reliance Electric* relies in large part on the fact that Emerson was not a beneficial owner at the time of the second sale, when it disposed of its remaining 9.6% interest in Dodge Manufacturing Company. We also note, however, that the Court in *Reliance* purposefully avoided a full analysis of the exemption clause, and in particular its application to the initial purchase in that case. 404 U.S. at 420-21. Our proposed construction of section 16(b) is in full harmony with the "congressional design of predicating liability upon an 'objective measure of proof'" 404 U.S. at 425, and would in every purchase/sale transaction yield the same result as that reached by the Court in *Reliance*. This is because in every purchase/sale transaction the "last" 10% held by a 16(b) defendant will have *pre-existed* any short-swing transaction, and thus will not be part of any 16(b) transaction for profit computation purposes. Under these circumstances we do not believe that *Reliance* forecloses our further analysis of the exemption clause or our development of an alternative construction thereof.

and sale transaction, or the sale and purchase transaction." It did neither, however, and we are left with the task of determining what construction will best serve the intended purposes of the statute. Given the legislative history of section 16(b) and the apparent logic of focusing all insider status inquiries on the period prior to the initiation of the short-swing transaction, we believe Congress intended by the language in question merely to indicate that in the case of both types of short-swing transactions, a person, to be charged with a section 16(b) violation, must only have had insider status prior to the *initial* purchase or sale.[13]

Since Gulf & Western did not occupy any section 16(b) insider position prior to the initial purchase of 3,000,000 shares of Allis-Chalmers common stock, its subsequent sale of this stock within six months did not trigger that section's conclusive presumption that a coordinated short-swing transaction based on inside information had taken place.

II

Turning to the September 30, 1968 acquisition of 248,000 shares of Allis-Chalmers common stock, it is not disputed that this purchase was executed at a time when Gulf & Western was a beneficial owner within the meaning of

[13] Nothing in the legislative history or the generally accepted purpose of section 16(b) would suggest a reason for requiring a beneficial interest at the time immedately before or after the closing component of a short-swing transaction. Possession of more than a 10% interest at this late stage could in no way relate to the possibility of speculative abuse, since any speculatve plan would be formulated prior to the opening purchase or sale, as we have indicated. Furthermore, requiring a beneficial interest in connection with the closing component encourages a dual-meaning approach to the words "at the time of," as evidenced by the opinion of the Ninth Circuit in *Provident*. 506 F.2d at 614. Such a dual-meaning approach defies rational justification in terms of legislative intent, and makes the words themselves almost meaningless. Moreover, in a limited class of cases, such a requirement would allow a careful insider to speculate with 16(b) impunity. Thus, where a beneficial owner anticipated a downward market, he could sell his entire interest and buy back only 9.9% within six months. With regard to this transaction he would never have been a beneficial owner at the time of the repurchase regardless of how the words "at the time of" might be construed, and yet as to that transaction he would have satisfied both section 16(b) presumptions: a) he initiated the transaction when he was an insider, giving rise to a presumption of access to inside information; b) he completed the transaction within six months, giving rise to a presumption that he used inside information to coordinate the sale and repurchase.

section 16(b).[14] The defendant contends, however, that the Oppenheimer purchase was so much a part of the original take-over bid by Gulf & Western, and so profoundly influenced by alleged resistance to the take-over bid by Allis-Chalmers, that a "pragmatic" approach to the application of section 16(b) is required. It is also contended that pragmatic analysis of the facts in this case compels a finding of nonliability since Gulf & Western was never in fact a functional insider of Allis-Chalmers, and did not, as a factual matter, obtain any inside information in connection with the purchase and sale of the 248,000 shares.

This argument is based on the decision of the Supreme Court in *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582 (1973). Gulf & Western urges that *Kern* is precedent for the proposition that section 16(b) should be applied only in those situations in which the transaction in question "*may* serve as a vehicle for the evil which Congress sought to prevent—the realization of short-swing profits based on access to inside information." 411 U.S. at 594. (emphasis added). In our view, the district judge properly determined that the rationale of the *Kern* case does not preclude liability under 16(b) for any profits realized by Gulf & Western as a result of the purchase and sale of the 248,000 shares obtained from Oppenheimer.

In *Kern*, defendant Occidental Petroleum Corporation had sought to initiate a merger with Kern County Land Company. This proved impossible, however, and Occidental decided to attempt a take-over of Kern through a tender offer to the Kern shareholders. In the course of the tender offer Occidental acquired well over ten percent of the outstanding shares of the target corporation.

[14] Under the construction of section 16(b) adopted in section I of this opinion, we need not pause to assess the significance of the fact that upon the execution of the sale of these shares to White Industries, Gulf & Western was no longer a beneficial owner within the meaning of the statute. It is interesting to note, however, that language in *Provident* would indicate that under the Ninth Circuit's view, liability would be avoided where, as here, one is not a beneficial owner "simultaneously with" the closing component of a section 16(b) transaction. 506 F.2d at 614-15 (quoted at pages 14-15 of this opinion).

tion. While the offer was in effect, Kern engineered a defensive merger with Tenneco, Inc., involving an exchange of all shares of Kern stock for shares of Tenneco stock. Prior to the closing of the defensive Kern/Tenneco merger, Occidental executed a call option agreement with Tenneco whereby Tenneco acquired the right to purchase from Occidental all Tenneco shares which would be acquired by Occidental in return for its shares of Kern stock under the proposed defensive Kern/Tenneco merger. By its terms, this option was not exercisable until six months after the last acquisition of Kern stock by Occidental.

Subsequently, but within six months of the original acquisition of Kern stock by Occidental, the Kern/Tenneco defensive merger was closed. At this point Occidental became irrevocably entitled to receive Tenneco shares in exchange for its Kern stock. Occidental purposely did not exercise this right until Tenneco exercised its call option more than six months after the last acquisition of Kern stock by Occidental. Immediately upon the exercise of Tenneco's option, Occidental tendered its Kern shares and disposed of its newly acquired Tenneco shares by transferring them to Tenneco pursuant to the option agreement.

In holding that Occidental was not liable to Kern under section 16(b), the Supreme Court determined that neither the acquisition of the irrevocable right to exchange its Kern shares for Tenneco shares pursuant to the defensive merger, nor the execution of the option agreement with Tenneco in reaction to that merger constituted a "sale" by Occidental within the meaning of the statute. The Court pointed out that the exchange of shares was required by the terms of the defensive merger and thus was not a voluntary act attributable to Occidental. No evidence existed to indicate that Occidental had in any way participated in the merger negotiations between Kern and Tenneco, and the continuous, short-term nature of the tender offer precluded any reasonable opportunity for Occidental to have premised its decision to acquire shares in excess of ten percent on insider's knowledge of

the Kern/Tenneco merger negotiations.[15] Once the defensive merger "crystallized" Occidental was left with no real option regarding the conversion of its Kern shares into Tenneco shares. Had Occidental decided to avoid the conversion of its shares under the merger by disposing of the shares to an outside purchaser prior to consummation of the merger, this sale would have fallen clearly within the section 16(b) "sale" concept and "would have left Occidental with a prima facie § 16(b) liability." 411 U.S. at 600. In light of these facts the Court held that the involuntary conversion of Occidental's Kern shares into those of Tenneco did not constitute a section 16(b) "sale" of the Kern stock.

With respect to the option agreement, the Court initially observed that "the mere execution of an option to sell is not generally regarded as a 'sale'." 411 U.S. at 601. The Court then proceeded to examine the particular option agreement at issue to determine whether this agreement amounted to a "sale" within the meaning of section 16(b) in terms of its potential for speculative abuse in connection with the prior acquisition of more than ten percent of the stock of Kern Company. In its analysis the Court noted that the option was not on Kern stock at all, but on Tenneco stock which might be received in exchange for Kern stock in the event that the defensive Kern/Tenneco merger was approved. Implicit in this observation was the recognition that Occidental never intended to sell its Kern holdings so long as Kern County Land Company retained its separate corporate identity. In addition, the facts showed that Occidental had worked diligently to prevent this merger from proceeding to consummation. The option agreement was further limited by the fact that

[15] The Occidental tender offer was on a first-come, first-served basis. Originally the offer was for a total of 500,000 shares, and this offer was announced on May 8, 1967. By May 10, this original offer was fully subscribed. On the following day the offer was extended to encompass an additional 500,000 shares. The offer expired on June 8, 1967 with Occidental owning a total of 887,549 shares of Kern stock. Occidental achieved 10% ownership when it acquired 432,800 shares. Since the decision to extend the offer was made on May 11, one day after the original offer for 500,000 shares was subscribed—and in all probability one day after Occidental first became a beneficial owner—the possibility that Occidental used information gained as an insider as a basis for its extension of the tender offer was virtually non-existent. 411 U.S. at 584-85 & note 6.

it was a call option and therefore unenforceable by Occidental even if the defensive merger were in fact closed and shares exchanged. Given these facts the Court concluded that the execution of the option agreement was also not a section 16(b) "sale" of Occidental's Kern interests.

The purchase and sale of the 248,000 shares of Allis-Chalmers stock acquired from Oppenheimer is not even remotely comparable to the transaction in *Kern*. The question in *Kern* was whether the term "sale" as used in the statute should be construed to apply to two very unorthodox transactions. In resolving this question the Court pierced the form of the two transactions to determine whether in substance either of the transactions amounted to a sale. The Court did not suggest that ordinary, voluntary transactions commonly recognized as purchases and sales would not automatically trigger the application of section 16(b) in future cases as they uniformly have in the past. Indeed the Court specifically recognized that:

> [t]he statute requires the inside, short-swing trader to disgorge all profits realized on all 'purchases' and 'sales' within the specified time period, without proof of actual abuse of insider information, and without proof of intent to profit on the basis of such information. 411 U.S. at 595.

In order to avoid this automatic rule under the *Kern* rationale, it would have to be shown 1) that either the purchase or the sale was an unorthodox transaction, and 2) that an analysis of the unorthodox transaction discloses no possibility of short-term speculative abuse.[16] The Oppenheimer purchase/sale transaction satisfies neither of these tests. The purchase of the Oppenheimer shares in Allis-Chalmers was a simple, voluntary purchase on the part of Gulf & Western. Certainly the fact that Gulf & Western used its own warrants rather than cash as consideration in this bargain does not render the purchase

[16] As the Supreme Court summarized in *Kern*:

> But the involuntary nature of Occidental's exchange, when coupled with the absence of the possibility of speculative abuse of inside information, convinces us that section 16(b) should not apply to transactions such as this one. 411 U.S. at 600.

unorthodox, and we do not understand Gulf & Western so to contend. Similarly, the sale of Gulf & Western's total interest in Allis-Chalmers to White was a simple, orthodox sale, albeit involving a rather complicated consideration element. Unlike the situation in *Kern*, there is nothing in the nature of these transactions which requires a judicial construction of the terms "purchase" or "sale," beyond giving these terms their commonly accepted meanings.

Moreover, even were we to assume that these transactions met the "unorthodox" test, nothing in the nature of these transactions precludes, or even reduces, the possibility of speculative abuse. The purchase from Oppenheimer was a planned business transaction, presumably undertaken as a profitable venture. Similarly, the sale to White was not involuntary, as in the case of a conversion into shares of another corporation pursuant to a defensive merger, nor was it conditional in any respect or tied to the future value of stock in a different corporation. On the contrary, at the time that Gulf & Western made its decision to purchase the 248,000 shares of Allis-Chalmers stock from Oppenheimer it was in a position to anticipate and control its future disposition of those shares. It voluntarily disposed of the shares within six months, *after* obtaining an indication from Allis-Chalmers' chairman that the future of that company did not look any too bright. The possibility certainly existed, therefore, that Gulf & Western's early disposition of its Allis-Chalmers shares was an attempt to avoid the effect of the predicted weakening of Allis-Chalmers' common stock, a prediction gained as an insider of that company. The application of section 16(b) is therefore automatic, and not in any way affected by a failure to prove up actual access to inside information, or improper use of such information.

III

Having found Gulf & Western liable for any profits realized from its purchase and sale within six months of the 248,000 shares of Allis-Chalmers stock obtained from Oppenheimer, we must determine whether the district court properly evaluated these profits. Allis-Chalmers contends that the district judge erred in his calculation of each element of damages thereby greatly reducing the liability of Gulf & Western.

A

With respect to the acquisition of the shares from Oppenheimer, the district court determined that the unregistered Gulf & Western warrants covered by that transaction should be evaluated at a per unit price of $15.92. This figure resulted in a total purchase price evaluation of $7,896,320.00 ($15.92 x 496,000 = $7,896,320.00). Allis-Chalmers points out that experts of both the defendant and the plaintiff evaluated the unregistered warrants at a much lower figure,[17] and that nothing in the record will support the $15.92 per share figure used by the district judge. It contends, therefore, that the value determination by the district court was clearly erroneous and should be set aside. We agree.

The district court's evaluation was the result of an erroneous assumption, namely, that a discount factor of fifteen percent which was recommended by two of the three expert witnesses did not reflect a full appraisal of the market value to be attributed to the guarantee by Gulf & Western relating to future registration of the 496,000 warrants. Gulf provided in its agreement with Oppenheimer that it would file a registration statement for the warrants (and related stock) on or before April 30, 1969, and in addition, that if it did not make effective a registration statement for these securities before December 31, 1968, it would guarantee Oppenheimer an average gross price per warrant of $13.50 for any warrants sold during the ninety days following the effective date of the registration statement. Also included in the agreement was a provision that in the event Oppenheimer should decide to sell the warrants under the guarantee, Gulf & Western would be given notice of the proposed sale and an opportunity for three business days to provide a buyer who would purchase the warrants from Oppenheimer at a higher price than the price to

[17] Plaintiffs' expert witnesses were Robert N. Hampton and Fred D. Stone. Hampton testified that considering all factors involved in the purchase agreement, a valuation per warrant of $14.25 would be proper, representing a discount of 9.5% from the low market trade on the closing date for identical registered warrants. Stone, also considering the entire agreement between the parties, testified that a range of from $12.92 to $13.70 would be accurate, representing a discount from low market of from 13% to 18%. Defendants' expert, Gabriel J. Danihel, on a similar basis, testified that a discount of 15% would be proper.

be obtained by Oppenheimer in its proposed sale. Each of the experts who testified on the subject of valuation of the unregistered warrants expressly indicated that his evaluation was based in part on the provisions of this guarantee. Each also expressed his final valuation in terms of a discount to be applied to the low market price for comparable registered Gulf & Western warrants being sold on the American Stock Exchange on the date of closing.

The district judge adopted a discount figure of fifteen percent as representative of the opinions of the experts and as realistic,[18] and applied this discount to the volume-weighted average price,[19] rather than the low price for registered warrants on the date of closing as urged by plaintiffs. He thereby arrived at a fair value per unregistered warrant of $13.69. Had the judge adopted $13.69 as the section 16(b) purchase price we would have no trouble affirming[20] as to this element of his calculation of damages.

[18] We find no substantial disagreement between the parties as to the propriety of this figure.

[19] The volume-weighted average price is determined for a given day by breaking the day's transactions into groups according to the price at which the security was traded, and then multiplying each price times the number of shares traded at that price, and dividing the total of these products by the total number of shares traded for the day. We discuss the propriety of using the volume-weighted average price in section III B, *infra*, in connection with the valuation of certain unregistered shares of White Consolidated Industries. That discussion applies to the use of the volume-weighted average price here, as well, since of a total of 29,600 warrants traded on the date of closing, only 700 (2.3%) were traded at the low market figure of $15⅞.

[20] Although Gulf & Western argues that the fact of non-registration does not or should not affect the cost *to it* of the warrants, and that the September 30, 1968 valuation should therefore equal the market value of registered warrants on that date, this argument ignores the value of money as a commodity. Gulf & Western elected not to purchase the Oppenheimer shares in Allis-Chalmers for cash. If it had possessed 496,000 registered warrants on September 30, 1968 it could have used these warrants and relied on their market value as reflected on the American Stock Exchange. It apparently had neither cash nor registered warrants, however, and therefore determined to use unregistered warrants. To Oppenheimer these warrants represented an allocation of capital to a non-liquid, speculative investment which would remain essentially non-liquid until registration on the American Stock Exchange. This accounts for the diminution in value to Oppenheimer attributable to the fact of non-registration. *See W. Fletcher, Cyclopedia of the Law of Private Corporations* § 8907, vol. 19, p. 67 (1959 ed.). On the other hand, Gulf & Western realized an immediate return for the non-registered warrants in the form of freely marketable Allis-Chalmers stock without the necessity of waiting the uncertain period

The district judge went on, however, to add to this "fair value" figure an increment of $2.23 as representing the value of the guarantee to register within three months, thereby attaining a final per unit valuation of the unregistered warrants of $15.92, or $.15 *more* than the low market transaction for registered warrants on the closing date and only $.19 less than the volume-weighted average price for that day for identical registered warrants. This was clearly error. Aside from the fact that the experts were nearly unanimous in their lower valuation of the unregistered warrants *with the guarantee* "for 16(b) purposes," and aside from the fact that Oppenheimer independently evaluated the warrants at $13.63 per warrant in a filing with the Securities and Exchange Commission, the addition of $2.23 to the conceded fair value of $13.69 per warrant does not withstand logical examination.

The effect of the guarantee as to Oppenheimer was twofold. First, it provided an incentive for Gulf & Western to make its best efforts to attain early registration, thereby reducing the period of non-liquidity for Oppenheimer. Second, it provided a limited hedge against significant loss on Oppenheimer's investment in the event Oppenheimer determined to sell its warrants within a period of ninety days after the effective date of registration in the event the December 31, 1968 registration date was not met. It did not remove all risk, however, since if the early registration date was met, no guarantee would be effective, and similarly, if the market in the warrants remained rela-

[20] (Continued)

required for registration of its warrants. By doing this Gulf & Western was able to shift to Oppenheimer and avoid for itself any tie-up of capital during the period of non-registration. To use an analogy, Gulf & Western was able to obtain immediate payment for an unfinished product coupled with a promise to complete the production process. By doing so it avoided the cost of financing the Oppenheimer purchase during the interim between September 30, 1968 and the date of registration. It cannot be denied that the true cost of producing a marketable warrant is less when one is paid early in the production process rather than after the process is completed. Given an assumed constant market value for the completed product, one who is paid prior to completion need only receive an amount sufficient to produce, through investment, the actual market value of the product as of the date of completion. A discount for non-registration was therefore appropriate. *Cf. Security Options Corp. v. Devilliers Nuclear Corp.*, 472 F.2d 844, 846 (2d Cir. 1972).

tively constant or increased from September 30, 1968 through the ninety days after effective registration, Oppenheimer, if it retained its warrants, would no longer be protected by the guarantee.

Turning to Gulf & Western, the guarantee has other, more significant features. On its face, it gave Gulf & Western a choice between early registration and possible liability under the $13.50 guarantee provision. More importantly, however, it gave Gulf & Western an opportunity to limit its own costs in the event the $13.50 guarantee was invoked, by giving Gulf & Western a three-day period during which it could *itself* repurchase the warrants at the guarantee price.[21] If it elected to do so, Gulf & Western could have effectively converted its stock acquisition to a cash purchase with the payment of the purchase price delayed for a period of several months after delivery of the Allis-Chalmers stock. If this were to happen, Gulf's "cost" would have been limited to the cost of preparing the unregistered warrants (negligible), plus the cost of registration, plus the purchase price of $13.50 per warrant, minus the market value of the use of the $13.50 per unregistered warrant during the interim between the September 30, 1968 closing and the purchase back of the warrants.

This analysis makes it clear that the guarantee could not have eliminated the disparity between the market value of the registered warrants being traded on the American Stock Exchange and the fair value of the unregistered warrants used in the Oppenheimer transaction, and that far from presenting an additional and costly risk to Gulf & Western, the guarantee actually presented a method to limit the "cost" of the warrants to well below the volume-weighted market value of $16.1144 for similar registered warrants as reflected on the date of closing.[22] The record in this case clearly supports the

[21] There is no express limitation on repurchase by a corporation of its own warrants in the corporate law of Delaware. DEL. CODE ANN. tit. 8, §§ 157, 160.

[22] Gulf & Western voluntarily extended the guarantee period on March 18, 1969 when Oppenheimer gave notice of its intent to sell its warrants. The extension did not avoid liability under the guarantee, however, since during the extension Oppenheimer sold pursuant to proper notice. Gulf & Western made payment under the guarantee in the sum of $2,154,437.50 on June 5, 1969. Apparently Gulf & Western believed this the better alternative to simply purchasing the warrants themselves at the $13.50 figure.

$13.69 figure drawn from the opinions of the experts, and we therefore adopt this evaluation as properly reflecting the section 16(b) purchase price of the Allis-Chalmers shares obtained from Oppenheimer. The full purchase price of these shares is therefore $6,790,240.00 ($13.69 x 496,000).

B

Turning to the December 6, 1968 sale by Gulf & Western of its entire holding 3,248,000 shares of Allis-Chalmers common stock to White, we must determine the section 16(b) value of the total consideration received from White and the proportional amount of this total consideration attributable to the 248,000 shares obtained from Oppenheimer. The total consideration received from White consisted of $20,000,000 in cash, 250,000 unregistered shares of White common stock, and an unsecured six month promissory note from White in the face amount of $93,680,000 at an interest rate of eight and one-half percent. The district court valued the 250,000 unregistered shares of White stock at seventy-five percent of the volume-weighted average price of identical registered shares being traded on the New York Stock Exchange on December 6, 1968. The White note was valued at ninety-five percent of its face amount. Allis-Chalmers says that the district court erred in both determinations.

Regarding the unregistered White common stock, Allis-Chalmers contends that the twenty-five percent discount, even if proper in amount, should have been applied to the high market price for identical registered shares traded on December 6, 1968 rather than to the volume-weighted average price for that day. The high price was $42.50 while the volume-weighted average price was $40.3458.[23] It is urged

[23] Curiously, Allis-Chalmers seems to contend at one point in its brief that a discount of 28% rather than 25% should have been employed. Thus, in its table of computations it figures on the basis of $42.50 discounted by 28% times 250,000 shares. The table shows a correct product of $7,650,000 for these figures which is then compared to the district court's figure of $7,613,493 to arrive at an alleged improper diminution in profit of $36,507 as a result of the judge's failure to use the $42.50 rather than the volume-weighted average price. But more significant is the district judge's use of a discount of 25% rather than the 28% shown in the Allis-Chalmers table. Had Allis-Chalmers used the 25% figure in its table, it would have reflected a

that use of the higher valuation was required under the rationale of *Bershad* v. *McDonough*, 428 F.2d 693 (7th Cir. 1970), *cert. denied*, 400 U.S. 992 (1971), and *Smolowe* v. *Delendo Corp.*, 136 F.2d 231 (2d Cir. 1943), *cert. denied*, 320 U.S. 751 (1943), in order "to squeeze all possible profits" from the transaction. 136 F.2d at 239. While we agree with the underlying principle of the *Bershad and Smolowe* cases,[24] we are unable to agree that use of the volume-weighted average price in this case offended that principle.

Smolowe was a case involving the problem of trade-matching. A section 16 (b) insider had engaged in numerous purchases and sales within a six month period and the question there was which purchase to match with which sales in order to compute section 16 (b) profits. After rejecting the possibility of using an "identity" test or the related "first-in, first-out" rule as being ineffective in the case of a large stockholder who could choose his opportunities to sell specific certificates and avoid section 16 (b) liability altogether, and after rejecting the notion of averaging all purchases and all sales within a six month period as effectively allowing a set-off of losses within the period in contravention of the provision in section 16 (b) that "any" profit be recovered, the court concluded:

> The statute is broadly remedial . . . . Recovery runs not to the stockholder, but to the corporation. We must suppose that the statute was intended to be thoroughgoing, to squeeze all possible profits out of stock transactions, and thus to establish a standard so high as to prevent any conflict between the selfish interest of a fiduciary officer, director, or stockholder and the faithful performance of his duty . . . . The only rule whereby all possible profits can be surely recovered is that of lowest price in, highest price out—within six months—as applied by the district court.

[23] (Continued)
diminution in "profits realized" resulting from the use of the volume-weighted average price (rather than the high market price) of $355,257 rather than the $36,507 figure. In the conclusion of its brief Allis-Chalmers in fact does combine the 25% discount with the $42.50 figure to reflect the true impact of the court's use of the volume-weighted average price.

[24] Plaintiffs also cite *Anderson* v. *Commissioner*, 480 F.2d 1034, 1037 (7th Cir. 1973), in support of their position, but this tax case adds nothing more than a general citation with approval of the *Bershad* and *Smolowe* cases.

> We affirm it here, defendants having failed to suggest another more reasonable rule. 136 F.2d at 239. (footnote omitted).

Nothing in this language suggests that the "lowest price in, highest price out" rule was meant to have application in cases where only one purchase or one sale has taken place so that trade-matching is not a problem, and the last sentence of the passage clearly indicates that even in trade-matching situations the rule is not absolute if a more reasonable method is suggested.[25]

Bershad did not involve valuation at all, but revolved around the question of whether the granting of a certain "option" to purchase stock amounted to a sale of that stock for section 16 (b) purposes. In determining that it did, this court noted the broad purpose of the section:

> Section 16 (b) was designed to prevent speculation in corporate securities by "insiders" such as directors, officers and large stockholders. Congress intended the statute to curb manipulative and unethical practices which result from the misuse of important corporate information for the personal aggrandizement or unfair profit of the insider. Congress hoped to insure the strict observance of the insider's fiduciary duties to outside shareholders and the corporation by removing the profit from short-swing dealings in corporate securities. Conversely, Congress sought to avoid unduly discouraging bona fide long-term contributions to corporate capital . . . .
>
> In order to achieve its goals, Congress chose a relatively arbitrary rule capable of easy administration. The objective standard of Section 16 (b) imposes strict liability upon substantially all transactions occurring within the statutory time period, regardless of the intent of the insider or the existence of actual speculation. This approach maximized the ability of the rule to eradicate speculative abuses by reducing difficulties

[25] Plaintiffs contend that *Newmark* v. *RKO General, Inc.*, 305 F. Supp. 310, 314 (S.D.N.Y. 1969), *aff'd*, 425 F.2d 348 (2d Cir. 1970), *cert. denied*, 400 U.S. 854 (1970), represents an application of the "general rule" in a non-trade matching situation. While it is true that the rule of "highest in" was there used, it is also clear that the "highest in" valuation was not objected to on appeal, 425 F.2d at 357, and extensive analysis of the use of this figure was never urged.

> in proof. Such arbitrary and sweeping coverage was deemed necessary to insure the optimum prophylactic effect. 428 F.2d at 696.

Though the court cited *Smolowe* in support of these statements, it cannot be argued that this general statement of purpose somehow enshrined in the law of this circuit a flat rule of lowest price in, highest price out for all valuation problems under section 16 (b). Valuation simply was not in issue in *Bershad*.

In this case, authenticated copies of the Fitch Report for December 6, 1968 trading in White common stock on the New York Stock Exchange disclosed that of a market volume of 31,300 shares traded for the day, only four hundred shares were traded at the market high price of \$42.50. This represents a scant 1.277 percent of the market in White shares. By far the largest single sale on December 6, 1968, a trade of 7600 shares, reflected a price of \$40.00—significantly less than the volume-weighted average price of \$40.3458. In addition, Allis-Chalmers' own expert testified that normal accounting procedure was "to figure . . . in terms of the average of the high and low price in a given day rather than one end or the other," and that he had made his discount computations from the high market figure in this instance only at the instruction of counsel for Allis-Chalmers.

We have held that the goal of squeezing out all profits "does not require a court to adopt a completely unrealistic interpretation of the market." *Mueller* v. *Korholz,* 449 F.2d 82, 87 (7th Cir. 1971), *cert. denied,* 405 U.S. 922 (1972). We find no error in the determination of the district court that it would be unreasonable and unrealistic here to attribute a market value of \$42.50 per share to a block of 250,000 shares of White common stock acquired on December 6, 1968. On the basis of the Fitch Report alone it would be difficult to reach a different conclusion. Section 16 (b), while it was intended to be thoroughgoing, was surely not intended to reject accuracy in favor of punitiveness.

Looking finally to the district court's valuation of the unsecured White note, we must determine whether the discount of five percent of the face amount of the note was properly applied. This discount was intended to account for the risk factors involved in a note of this size and to

produce a value reflecting what "the disinterested but available third party investor" would pay for the note on December 6, 1968. In adopting the ninety-five percent valuation figure the court rejected undisputed evidence that the note was in fact paid in full with interest by White three and one-half months after closing. The question therefore becomes whether the difference between the market value of the note and the actual value the note produced for Gulf & Western falls within the statutory phrase "any profit realized." We have no hesitation in holding that it does.

As we have previously noted, section 16 (b) was designed to curb misuse of inside information by removing profit from a class of transactions deemed by Congress to present an intolerable invitation for such abuse. *Reliance Electric Co.* v. *Emerson Electric Co.,* 404 U.S. 418, 422 (1972). All transactions within the class are tainted with a presumption that inside information has been misused, and the presumption precludes any defense based on the showing of a "clean heart" by the section 16 (b) defendant. *Id,* at 424 n. 4; *Newmark* v. *RKO General, Inc.,* 425 F.2d 348, 353 (2d Cir. 1970), *cert. denied,* 400 U.S. 854 (1970). It should be noted, however, that the statute does no more than remove the profit from such transactions. It does not inflict an affirmative fine or penalty. Thus, one who is forced by personal circumstances into a section 16 (b) transaction does not face financial ruination, but merely the prospect that his short-term investment of capital has not produced a positive gain.

Given the broad remedial purpose of section 16 (b), its limited impact, and the intent of Congress in drafting this section to "eradicate speculative abuses by reducing difficulties in proof," *Bershad* v. *McDonough,* 428 F.2d at 696, we hold that in transactions involving debt obligations of an amount certain, evidence of payment in full, if available at the time of trial, should control the determination of "profit realized."[26] We cannot help but wonder whether

[26] The evidence showed that the prime rate of interest at the time of this transaction was 6½%. Expert testimony indicated that the nature of the note and the circumstances surrounding the sale to White justified the higher 8½% rate agreed to by the parties. There has been no contention that the increment over the prime rate was used to conceal 16(b) profits by artificially reducing the face amount of the note.

Gulf & Western's present belief that estimated market value at the time of closing is the only proper measure of 16 (b) liability could have withstood the strains of a situation where White had in fact defaulted on the note completely. In any event, a rule of evaluation which looks to the realities in such situations will avoid the possibility that real profits will escape the reach of the statute or that non-existent profits will be "recovered." We believe this to be no more nor less than the language of the section requires.

IV

To summarize, the consideration received from White Industries is properly evaluated as follows: $20,000,000 in cash, plus $7,564,837.50 in unregistered White common stock (250,000 × $40.3458 × .75 discount factor), plus $93,680,000 in the form of the White promissory note, for a total consideration of $121,244,837.50. This figure must be prorated to reflect the portion attributable to the Oppenheimer purchase. A simple method of doing this is to divide the total consideration by the total number of shares sold ($121,244,837.50 ÷ 3,248,000 = $37.3291) and then multiply the resulting per-share figure by 248,000. Using this method a proportional consideration for the 248,000 shares of $9,257,616.80 is produced. Substracting the acquisition price of $6,790,240.00 from this figure yields a gross profit allocable to the Oppenheimer transaction of $2,467,-376.80. From this figure must be deducted the stipulated expenses incurred by Gulf in connection with the Oppenheimer purchase in the amount $1,696.33. The resulting net profit for section 16 (b) purposes is $2,465,680.47.

The judgment of the district court is therefore reversed in part and remanded for entry of judgment in favor of Allis-Chalmers in the amount of $2,465,680.47. Each party is to bear its own costs.

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Clerk of the United States Court of Appeals for the Seventh Circuit

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APPENDIX B

Opinion of the United States District Court for the Northern District of Illinois

IN THE

UNITED STATES DISTRICT COURT

FOR THE NORTHERN DISTRICT OF ILLINOIS

EASTERN DIVISION

No. 70 C 513 and No. 69 C 627

ALLIS-CHALMERS MANUFACTURING COMPANY, a Delaware corporation,

Plaintiff,

v.

GULF & WESTERN INDUSTRIES, INC., a Delaware corporation,

Defendant.

This action was commenced on January 6, 1969 in the United States District Court for the Eastern District of Wisconsin by plaintiff, Allis-Chalmers Manufacturing Company, now Allis-Chalmers Corporation (hereinafter referred to as "Allis"). Plaintiff seeks to recover alleged short-swing profits from Gulf & Western Industries, Inc. (hereinafter referred to as "G&W") under Section 16(b) of the Securities Exchange Act of 1934 (15 U.S.C. § 78 p (b)) alleged by plaintiff to have been realized by G&W as a result of two purchases in July and September of 1968 aggregating 3,248,000 shares of Allis common stock and the subsequent sale of these shares on December 6, 1968.

Pursuant to a motion by G&W under 28 U.S.C. § 1406(a) that venue was improper in the Eastern District of Wisconsin the case was transferred to this District. *Allis-Chalmers Mfg. Co.* v. *Gulf & Western Industries, Inc.*, 309 F. Supp. 75 (E.D. Wis. 1970). At the same time G&W commenced an action in this Court for declaratory judgment. *Gulf & Western Industries, Inc.* v. *Allis-Chalmers Manufacturing Company,* (69 C 627). On March 23, 1970 the two actions were consolidated and this Court ordered the consolidated action to proceed on the basis of Allis' Amended Complaint which was originally filed on February 19, 1970 in the Eastern District of Wisconsin.

Allis, a corporation organized under the laws of the State of Delaware, having its principal office in West Allis, Wisconsin, is a manufacturing company engaged in the manufacture of agricultural, construction, industrial and electrical machinery and related equipment.

G&W, a corporation organized under the laws of Delaware, having its principal office in the City and State of New York, is a diversified company engaged in a variety of businesses, including manufacturing, distribution, leisure time operations and the production of minerals, metals and certain agricultural and consumer products.

During the period June 30, 1968 and December 31, 1968 there were between 10,364,102 and 10,410,292 shares of Allis common stock issued and outstanding. 3,000,000 of these shares were purchased by G&W through an Exchange Offer made to all Allis shareholders, and 248,000 shares of them were bought from the Oppenheimer Fund, Inc.

On May 7, 1968 G&W publicly announced to all Allis shareholders that it would make an Exchange Offer in accordance with a registration statement and prospectus filed and published as required by the Securities Act of 1933. G&W proposed to purchase on a pro-rata basis up to

3,000,000 such shares. Under the proposed offer Allis shareholders would receive for each share of Allis common stock: (a) $11.50 in cash, (b) $12.50 principal amount of a 6% subordinated 20-year nonconvertible debenture ("the G&W 6% Debenture"), and (c) 9/10 of a 10-year registered warrant to purchase G&W common stock at $55 per share ("the G&W Warrant").

There is a major dispute as to the date on which the purchase of the 3,000,000 shares of Allis common stock occurred. G&W contends that the date was July 29, 1968; Allis contends the date was July 31, 1968. Both parties agree that G&W's purchase of the additional 248,000 shares of Allis' common from the Oppenheimer Fund took place later on September 30, 1968. In exchange for these 248,000 shares G&W gave Oppenheimer 496,000 unregistered G&W warrants.

On December 6, 1968 G&W sold its entire block of 3,248,000 shares of Allis' common stock to White Consolidated Industries, Inc. (hereinafter referred to as "White") in exchange for: (a) 250,000 unregistered shares of White common stock, (b) White's unsecured 8½% promissory note in the face amount of $93,680,000 payable in six months, and (c) $20,000,000 in cash.

Allis now seeks to recover what it alleges are short-swing profits of $16,305,251 which it contends G&W realized from its two purchases in July and September 1968 and its subsequent sale in December of 1968 of the 3,248,000 shares of Allis common stock. The total sales price is alleged to have been $121,330,000. Allis' position is that the purchases and the sale both occurred within less than six months. Allis claims that the amount of the sale together with the dividends received by G&W during this less than six month period, minus its stipulated cost of acquiring and selling the 3,248,000 shares constitute the amount of profit. Allis also

seeks to recover interest at 6% on G&W's profits from the date of sale, December 6, 1968, to the date of entry of judgment.

G&W's Answer to the Amended Complaint denies all material allegations of the Complaint, and specifically alleges, *inter alia*, that G&W was not a beneficial owner of more than 10% of Allis' stock at the time of its acquiring through the Exchange Offer the 3,000,000 Allis shares, and that this is required by Section 16(b). G&W contends that since its acquisition of the 3,000,000 Allis shares was pursuant to an Exchange Offer regulated by the Securities Act of 1933 the transaction would be excluded from the purpose of Section 16(b). G&W further charges that the sale of its 3,248,000 Allis shares was induced by "duress and hostility" to G&W, originating with Allis and inflamed through Allis' encouragement of Federal Trade Commission proceedings against G&W. G&W thus denies liability. But then, going further, G&W claims that even if there is liability, it realized no profit from the transactions and there would be no money due to Allis as a result of this action.

Liability

The jurisdiction of this Court is asserted under Section 27 of the Securities Exchange Act of 1934 (15 U.S.C. 78aa).

Section 16(b) of the Act states as follows:

> "For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of

> less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection."

Section 16(b), thus, provides that liability attaches to 10% beneficial owners who are such: ". . . both at the time of the purchase and sale, or the sale and purchase of the security involved. . . ."

G&W contends in one of its affirmative defenses that as to the 3,000,000 shares of plaintiff's common stock acquired by G&W pursuant to the Exchange Offer, G&W is not liable to Allis for any profits that may have been realized upon

the sale to White since at that point in time when G&W acquired the 3,000,000 shares G&W was not a beneficial owner of more than 10% of Allis' equity security within the terms of the statute. This would mean that it then *became* the owner of more than 10%, and only a subsequent acquisition would bring the statute into play.

Allis, however, contends that on an *initial* purchase of more than 10% one becomes such a holder of more than 10% of the stock of a company as to trigger the applicability of Section 16(b). To bolster its contention that one becomes subject to Section 16(b) at the time of the purchase which turns one into a 10% beneficial owner irrespective of the percentage of his prior holdings, if any, Allis quotes from the recent decision in *Kern County Land Co.* v. *Occidental Petroleum Corp.*, 411 U.S. 582, 584 (May 7, 1973):

> "Unquestionably, one or more statutory purchases occurs when one company, seeking to gain control of another, acquires more than 10% of the stock of the latter through a tender offer made to its shareholders."

In the *Kern County* case defendant, Occidental Petroleum Corporation, made a tender offer for shares of the Kern County Land Company (hereinafter referred to as "Old Kern"). That offer became effective on May 8, 1967 and by May 10 more than 10% of the shares had been tendered. The Court found that Occidental became a beneficial owner within the terms of 16(b) when pursuant to its tender offer it purchased more than 10% of the outstanding shares of Old Kern.

G&W relies upon *Kern County* also. This is because in that case a tender offer was involved, which like the exchange offer here, raised the question of whether or not the

nature of the purchase was reached by the statutory definition.[1]

A careful analysis of the case law including *Kern County* leads me to the conclusion that G&W by its initial purchase, became a beneficial owner of more than 10% of Allis' stock. In construing the words "at the time" as used in the statute the Court in *Stella* v. *Graham-Paige Motors Corp.*, 104 F.Supp. 957 (S.D.N.Y. 1952), *aff'd in part, remanded in part*, 232 F.2d 299 (2d. Cir.), *cert. denied*, 352 U.S. 831 (1956) said as follows at 960:

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[1] Pertinent language in the decision includes the following from 593-595:

> "Although traditional cash-for-stock transactions that result in a purchase and sale or a sale and purchase within the six month statutory period are clearly encompassed within the purview of § 16(b), the courts have wrestled with the question of inclusion or exclusion of certain 'unorthodox' transactions. The statutory definitions of 'purchase' and 'sale' are broad and, at least arguably, reach many transactions not ordinarily deemed a sale or purchase. In deciding whether borderline transactions are within the reach of the statute, the courts have come to inquire whether the transactions may serve as a vehicle for the evil which Congress sought to prevent—the realization of short-swing profits based upon access to inside information—thereby endeavoring to implement congressional objectives without extending the reach of the statute beyond its intended limits. The statute requires the inside, short-swing trader to disgorge all profits realized on all 'purchases' and 'sales' within the specified time period, without proof of actual abuse of insider information, and without proof of intent to profit on the basis of such information. Under these strict terms, the prevailing view is to apply the statute only when its application would serve its goals. [W]here alternative constructions of the terms of §16(b) are possible, those terms are to be given the construction that best serves the congressional purpose of curbing short-swing speculation by corporate insiders. *Reliance Electric Co.* v. *Emerson Electric Co., supra,* at 424. See *Blau* v. *Lamb*, 363 F.2d 507 (CA2 1966), cert. denied, 383 U.S. 1002 (1967). * * * [Thus] "[i]n, interpreting the terms 'purchase' and 'sale', courts have properly asked whether the particular type of transaction involved is one that gives rise to speculative abuse."

"... if the words 'at the time' are construed to mean 'simultaneously with' a shareholder would become subject to the provisions of §16(b) as soon as his ownership exceeded 10% of the outstanding shares. This construction would be consistent with the declared purpose of the statute to prevent the unfair use of inside information by officers, directors, or stockholders owning more than 10% of the equity stock."

Through the years since the *Stella* decision the Courts have followed its thinking in construing the words "at the time of the purchase and sale" to apply to shareholders immediately upon their acquisition of more than 10% of a corporation's securities. In *Bershad* v. *McDonough*, 300 F.Supp. 1051 (N.D.Ill. 1969) *aff'd*, 428 F.2d 693 (7th Cir. 1970), *cert. denied*, 400 U.S. 992 (1971), as in *Kern County*, *supra*, the Court was concerned with whether the granting of an option was a sale (the back end of the transaction) within the confines of Section 16(b). However, it is clear that the Courts would not have concerned themselves with that issue had they first not reasoned that Section 16(b) liability turned on an initial acquisition exceeding 10% serving to set in motion the 6 month period. In accord with these cases are the holdings in *Emerson Electric Co.* v. *Reliance Electric Co.*, 434 F.2d 918 (8th Cir. 1970), *aff'd on other grounds*, 404 U.S. 418 (1972); *Blau* v. *Lamb*, 363 F.2d 507 (1966), *cert. denied*, 385 U.S. 1002 (1967); and *Newmark* v. *RKO General, Inc.*, 425 F.2d 348 (1970), *cert. denied*, 400 U.S. 854 (1970).

On the facts before me, I conclude that G&W became a beneficial owner of more than 10% of Allis' common stock at the time of its purchase, by tender offer, of the 3,000,000 shares of Allis' stock. However, G&W argues that even if

it became a 10% owner of Allis' common stock at the time it acquired by tender offer almost a third of Allis' equitable ownership and sold the whole of it within six months, it is exempt from the operation of Section 16(b) because the purchase was "unorthodox" and "unorthodox" transactions do not involve the type of abuse Section 16(b) was enacted to prevent.

G&W presents a strong argument for the proposition that its initial acquisition of the Allis shares by an Exchange Offer was not the traditional cash-for-stock purchase that Congress considered in passing Section 16(b). Rather, G&W contends, it was a hybrid type of transaction with unique characteristics closely resembling a merger. G&W says that it would be erroneous to consider the legal consequences of G&W's acquisition of the stock apart from the disclosure process with which it alleges "it was inextricably connected." The argument is that Exchange Offers (as distinct from cash transactions) are surrounded by numerous legal safeguards which are designed to guarantee full disclosure to all shareholders and thus by their very nature are unsuited to short-swing speculation based on inside information.

In effect, the argument is that since the acquisition was conducted in accordance with the methods established by the Securities and Exchange Commission and Congress, i.e., pursuant to a registered Exchange Offer and by a Prospectus, G&W was not automatically an insider nor was there any possibility of abuse as a result of the nature of the transaction. Its offer, G&W contends, was subject to the prohibition against the use of any Prospectus (or Registration Statement) which contained "any untrue statement of fact or omission of a material fact required to be stated * * * or necessary to make the statements therein not misleading." Such prohibition appears in a

number of sections of the Securities Act of 1933, 15 U.S.C. §§ 77k, 77l, 77q, 77x. Accordingly, G&W maintains, it caused all material information regarding Allis to be released to the public and placed in the hands of each Allis shareholder and that these actions afforded all parties to the proposed exchange an equal informational footing, eliminating thereby any advantage to G&W.

In opposition to this contention Allis ignores certain words of *Kern County*, "unorthodox sale—not a sale within the meaning of 16(b)", and argues that an unfettered reading of the language of Section 16(b) makes it clear that the statute does not require any showing that an insider had inside information in order for liability to attach. The suggestion that full and truthful disclosure of what is known is required by some other necessary proceedings, according to Allis, creates no defense to the charge that there was an actionable purchase.

It is true that the court in *Kern County* found that an unsuccessful takeover bidder who converted shares of the target company into the merged entity's shares was not liable for short-swing profits when it was found that there had been no opportunity for speculative abuse. The target corporation, Old Kern, had vigorously opposed Occidental's takeover bid and to thwart such a takeover had arranged a "defensive merger" with Tenneco. Due to the merger of Old Kern and Tenneco, Occidental was virtually forced to exchange the Old Kern shares that it had acquired by its tender offer for those of Tenneco. The successor corporation to Old Kern brought suit to recover the alleged Section 16(b) profits realized by Occidental. The court concluded that the transaction having been forced upon Occidental did not constitute a "sale" within the purview of Section 16(b). The court noted that the merger left Occidental with no appraisal rights under California laws;

but that any other sale of Old Kern shares for cash before the merger closed "would have left Occidental with a prima facie § 16(b) liability." *Supra* at 600.

I am convinced that with these words the Supreme Court recognized that where, for example, a purchase carries sufficent indicia of full disclosure of all information available to the purchaser, and its sale is an economically or legally coerced involuntary act the transaction is not intended by Congress to be unlawful; but that when the sale is clearly voluntary a prima facie Section 16(b) violation would exist. When we on the trial bench try to facilitate our determination by limiting liability to simple categories, such as "orthodox" and "unorthodox", we may easily blind ourselves to the kinds of abuses to which Congress directed 16(b). The 1934 Senate Report on Stock Exchange Practices (*Senate Comm. on Banking and Currency*), Stock Exchange Practices, S. Rep. No. 1455, 73rd Congress, 73 Cong. 2d Sess. 55 (1934) stated:

> "Among the most vicious practices unearthed at the hearings before this subcommittee was the flagrant betrayal of their fiduciary duties by directors and officers of corporations * * *. Closely allied to this type of abuse was the unscrupulous employment of inside information by large stockholders who, while not directors or officers, exercise sufficient control over the destinies of their companies to enable them to acquire and profit by information not available to others."

Even though *Kern County* is a clear repudiation of the "cold turkey" application of statutory liability in 16(b) cases, nowhere in *Kern County* does the Supreme Court take out of 16(b) its application to a short-swing transaction just because there was in fact no access to inside informa-

tion. It leaves the statute applicable to types of transactions that give "rise to speculative abuse". (*Kern County* at 595.) Under *Kern County* (594 fn. 26) the language of this Circuit in *Bershad* v. *McDonough*, 428 F.2d 693 (7th Cir. 1970), was confirmed. Then it went one step further. It announced a flexible "possibility of abuse" test to be applied to each case on the facts regarding its questioned transaction. The specific transaction itself must permit the possibility of or potential for abuse. (*Kern County* at 595.)

The question is whether or not an outsider becoming a prima facie insider, such as defendant, by virtue of a tender offer to purchase one third of plaintiff's common stock, under the circumstances of this case, engages in that type of transaction which Congress determined gives rise to the possibility of or potential for speculative abuses. By virtue of the nature and amount of the purchase, such purchaser generally places himself or itself in a position to at least exercise substantial influence over the decisions of the corporation, if not control. From this position information can be acquired not otherwise available to the public. Stock value changes can be reliably anticipated if not maneuvered. The desirable speculative character of a free market can be wrecked by the cumulative effect of a substantial amount of such piracy. The danger, of course, in each instance, is not easily established by evidence of actual manipulation or intent to manipulate.

Some corporations have as their primary occupation dealing in the stock of other corporations. Some buy and sell units of corporate control for profit. It seems to me that irrespective of whether the purchase under these circumstances is handled in an "orthodox" or an "unorthodox" manner, it can constitute one of the types of conduct which Section 16(b) was intended to reach.

This does not mean that Congress sought by this law to stop or even dissuade corporations from using their equity for moving in and out of positions of control or effective influence in other corporations, either for the purpose of investment or the purpose of acquiring on a trial and error basis absorbable corporate operations. The statute does intend to include corporate conduct out of which buying and selling for profit from an insider's perspective can occur. The evidence in the case before me shows defendant, G&W, as having engaged in a substantial number of transactions involving the purchase and sale of controlling interests in other corporations.[2] There is nothing in the evidence to establish that G&W's acquisitions and dispositions were for the purpose of gaining inside information to be used selling stock positions in corporations for profit, or that it actually did have inside information when it bought or sold. I am confident that the greater weight of the evidence presented to me does not establish that G&W had inside information of the character contemplated by Section 16(b) either before or after its purchase of Allis. But I am convinced that its position both at the time of the purchase and at the time of the sale was such as would, in many such situations, per-

[2] Its chief executive officer, when asked to confirm or reject a statement appearing in the February 15, 1973 edition of the Wall Street Journal, stated that he "would not reject the statement." The statement was that, from 1958 through 1968:

> "* * * G&W acquired about 130 companies, usually using its own securities or packages of its securities and warrants to buy the companies. At first the acquisitions were complementary with G&W's main lines of business, but later it branched out in all directions. The big year was 1968 when 23 acquisitions came under G&W's wing. * * * G&W that year similarly withdrew from stock positions in other large companies—Armour and Co., Allis-Chalmers Manfg. Co., and Sinclair Oil Corp. In fact over the years, G&W has bought in and out of companies both for investment reasons and for the purpose of acquisition and complete control."

mit access to information not otherwise available to the general public.

Allis failed to establish that G&W did have inside information both at the time of the purchase and at the time of the sale. What was shown was that in May of 1968 G&W's president was told by the head of a California investment firm that he had encouraged an investment firm to seek a merger with Allis; that Allis had been interested in being a part of a profitable merger; that the investment company and Allis had entered into a preliminary agreement to merge, but that the plan fell through because the investment firm believed a heavy manufacturing business inherently risky. This cannot be considered the type of inside information to which the statute refers. In addition, what was shown was that in September of 1968, before G&W sold its Allis stock, Allis' president told G&W's president that Allis' performance during that quarter of the year was extremely poor and that its earnings had declined sharply, but the inference to be drawn from this was that Allis sought to discourage G&W's retention of its stock position in Allis. Other information given G&W by Allis was almost contemporaneously made public.

G&W asserted as an affirmative defense the *absence* of inside information; but here again I find the facts insufficient. A fact does not exist here which is found in other cases in which this affirmative defense has succeeded. The missing fact is that plaintiff's conduct locked the defendant outside so effectively that the defendant could not have acquired inside information had it wanted to. This is what happened in *Kern County*, and in *Gold* v. *Sloan*, 486 F.2d 340 (4th Cir. 1973).

I further find the facts insufficient to establish as an affirmative defense that G&W was *compelled* to sell its stock in Allis before the expiration of the statutory period. Occidental was not only locked out in *Kern County*, but under

the circumstances was left no realistic alternative to disposing of its stock in Old Kern. Its only alternative would have left it with a prima facie 16(b) liability. Of the same order was the circumstance which compelled Scurlock in *Gold* v. *Sloan* to acquire the Susquehanna stock, part of which he sold within six months. G&W was here not *caught* in a merger. The one clear-cut defensive tactic of Allis, slashing its quarterly dividend in half after G&W had acquired one third of its common stock, as offensive as G&W may have felt it, was nevertheless not an act which compelled a sale some fifty odd days before the end of the statutory period.

Valuation

Section 16(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78(b)), provides that "for the purpose of preventing the unfair use of [inside] information," the beneficial owner shall pay over to the complaining corporation any profit realized by the purchase and sale. What then is the amount, if any, Allis is entitled to be paid by G&W is the remaining question. Allis contends that the amount is $16,305,251, with additional interest to the date of the entry of judgment. G&W contends that there was no profit, but rather a loss, and that Allis would be entitled to nothing.

The issue of the amount of profits to be accounted for where there is a 16(b) liability calls into play, when the consideration given or received is other than cash, certain principles of valuation. Were the consideration given and received cash only, the problem would be a simple one; but in most of these cases it usually is not just cash. Most of the cases under 16(b) cited by the parties in their briefs, in which liability had been found, involved consideration other than cash.

In this case the purchases were made with some cash, but principally with G&W warrants and debentures; and the sale was made for some cash, but principally for certain unregistered shares of common stock of White, and an unsecured six month corporate promissory note. Valuations of these other-than-cash considerations was the matter to which both sides were requested to and did direct much of their attention in testimony, exhibits and argument. The testimony and opinions of expert witnesses was presented at great length by both sides. Were the position of the plaintiff and its experts accepted completely, the defendant would be accountable for $12,741,788 in profits, for dividends and for interest from the date of the sale to the date of this decision. Were the position of the defendant and its experts accepted completely, it would be found that the defendant, through no fault of its own, lost $11,545,566 (if not $13,-699,993) in the purchase and sale. The differences of more than 30 million dollars between the positions of the parties and their experts must be resolved by applying to the facts basic principles of valuation derived from authorities in the field of securities and accounting, and from cases interpreting valuations in 16(b) cases.

The Court itself must determine the fair market value or the fair value (in the absence of a market) of the consideration given up and received in a 16(b) case. Real or actual values, as in other cases, may require investigation of the affairs of the corporations and businesses involved; but the situs of the 16(b) valuation is the actual or presumed market place. *Park & Tilford, Inc.* v. *Schulte*, 160 F.2d 984, 990 (2nd Cir.) cert. denied 332 U.S. 761 (1947).

Where in determining valuation two or more interpretations may equally be drawn from the same facts, the Court may adopt the one least favorable or most favorable to the defendant as the relative equities of the parties dictate; but

in doing so the Court is not required to adopt a completely unrealistic interpretation of the market. *Mueller* v. *Korholz*, 449 F.2d 82, 87 (7th Cir. 1971). One of the major disagreements between the parties in this case is the plaintiff's insistence that in 16(b) cases, valuations always must be read in the light least favorable to the defendant or most favorable to the plaintiff.

The concept of maximizing profit by using such theories as "lowest in and highest out" as espoused in the 1943 decision of the 2nd Circuit in *Smolowe* v. *Delendo Corporation*, 136 F.2d 231, 239, is not the law in this (7th) Circuit. In *Mueller, supra* at 87, we are admonished not to adopt a completely unrealistic interpretation in the name of advancing the Congressional purpose. In that case the Seventh Circuit was confronted with the problem of valuing the defendant Korholz's holdings of "Gypsum" stock traded in the over-the-counter market. No evidence was presented of actual trades on the date in question, but there was evidence of dealers "making a market" in Gypsum stock. Their quotations ranged from 6 to 6¾ on the "bid" side and from 7¼ to 7⅛ on the "asked" side. This meant that the best bid Korholz could have received from his shares was 6¾. As the Seventh Circuit explained, the plaintiff contended:

> " * * * as a matter of law that the low bid price of $6.00 was the only acceptable evidence of value because the policy of § 16(b) requires the Court to adopt an interpretation of the facts that will 'squeeze out all possible profit.' *Cf. Smolowe* v. *Delendo Corp.*, 136 F.2d 231 (2 Cir. 1943)."

Then explaining away the language of the Second Circuit, the court in *Mueller* went on to say at 87:

> "The comment in that case [Smolowe; supra] may guide a court's choice between two reasonable interpretations of the facts. *It does not require a court to adopt a completely unrealistic interpretation of the market.*" (Emphasis added.)

The court thereafter proceeded to affirm a valuation based not on $6.00 the low bid, nor even on the $6.75 best bid, but on a $6.875 "average price or value" on the relevant date.

There are numerous cases in which courts have chosen either the high or low figure for what appeared to be punitive purposes. *Blau* v. *Lamb*, 242 F.Supp. 151 (S.D. N.Y. 1965), rev'd and aff'd in part, 363 F.2d 507 (2 Cir. 1966), cert. denied 385 U.S. 1002 (1967); *Marquette Cement Mfg. Co.* v. *Andreas*, 239 F.Supp. 962 (S.D.N.Y. 1965); *Gratz* v. *Claughton*, 187 F.2d 46 (2d Cir.), cert. denied, 341 U.S. 920 (1951); *Heli-Coil Corp.* v. *Webster*, 222 F.Supp. 831 (D.N.J. 1963), aff'd as modified, 352 F.2d 156 (3d Cir. 1965); *Blau* v. *Lehman*, 173 F.Supp. 590 (S.D.N.Y. 1959), aff'd 286 F.2d 786 (2 Cir. 1960), aff'd, 368 U.S. 403 (1962). But it appears to me that in those cases the trial courts must have been without evidence from which realistic values might have been computed. As a result of evidentiary default, and faced with a decisional necessity, they resolved the issue through "stop-gap" application of Congressional purpose. *Mueller*'s understanding of *Smolowe* would apply also to them. Even so, *Mueller*'s admonition to the trier of fact to seek from the evidence, if at all possible, a basis upon which a realistic interpretation of fair market value can be made, is to me a highly responsible mandate.

The Purchase

During the six month period involved in this case there were between 10,363,102 and 10,410,292 shares of Allis' common stock issued and outstanding. G&W opened it by buying 3,000,000 shares through an exchange offer and later acquired directly from the Oppenheimer Fund, Inc., an additional 248,000 shares. Before the end of the period G&W sold all 3,248,000 to a single purchaser, White Consolidated Industries, Inc.

The parties disagree as to the date upon which G&W acquired the 3,000,000 shares, not because it was the day that began the six month countdown, but because of the substantial difference in value of the stock on the different dates asserted by the parties to be the date of purchase. The exchange offer was publicly noticed through the press by G&W on May 7, 1968. There is no evidence as to whether or not there was any awareness of G&W's intentions prior to that date. The offer was to purchase from all Allis shareholders on a pro-rata basis up to 3,000,000 shares, offering in exchange for each share: $11.50 in cash; 9/10 of a warrant to expire January 31, 1978 to acquire a share of G&W common at $55; and a $12.50 principal amount of a 6% G&W Subordinate Debenture to be due July 1, 1988. According to the proxy statement the exchange offer was conditioned on approval of G&W shareholders on July 29, 1968. If this approval were forthcoming, G&W would accept all Allis shares tendered up to 3,000,000. If more than 3,000,000 would have been tendered by July 19, 1968, all would be accepted on a pro-rata basis. If fewer than 3,000,000 would have been tendered by July 19, G&W would accept all shares tendered after that date in their order of receipt up to 3,000,000 shares. All tenders were irrevocable.

Before July 29, 1968, more than 3,000,000 Allis shares had been tendered, and on that date G&W's shareholders approved the Exchange Offer. Thereafter, in the "Initial Statement of Beneficial Ownership of Securities" required by Section 16(a) of the Securities Exchange Act of 1934 to be filed with the SEC, it was stated that G&W acquired 3,000,000 shares of Allis' common on July 31, 1968. In G&W's monthly report to the SEC for the month of July, 1968, it was stated that "Registrant, on July 31, 1968, acquired 3,000,000 shares of common stock of Allis-Chalmers." In a document called "Welcome to Gulf & Western" sent out to the new G&W warrant holders under the exchange offer, it was stated that "The effective date of the Exchange was July 31, 1973." G&W's warrant agent dated all warrants given in exchange for Allis common, on the date July 31, 1968, and an answer by G&W to one of Allis' interrogations filed in these proceedings contained sufficient reference to July 31, 1968, to generate a contention by Allis that G&W judicially admitted July 31st to be the acquisition date; but the certainty of that answer as an admission is clouded by the nature of the answer and the context within which it was given.

Using July 29, 1968 as the valuation date itself, G&W comes out with a gross purchase price per Allis share of $37.93. Using July 31 as a controlling date, Allis comes out with a gross purchase price per Allis share of $35.37. This difference, crudely stated, of $2.56 per share, places the parties initially seven million dollars apart in their computations.

Allis contends that the court is bound by the manner in which G&W handled the exchange offer in its accounting, public and judicial records, and statements. Allis contends that as far as possible the court must resolve issues in favor of the plaintiff, because 16(b) is "remedial". Thus

Allis, by holding G&W to the July 31st date, a day on which the stock market was closed, acquires August 1st as the valuation date, a day which, over July 29th, substantially maximizes profit. On August 1st nothing happened between the parties. On July 29th G&W itself became irrevocably bound to Allis' shareholders who in reliance on the terms of the exchange offer had irrevocably tendered their stock for securities that in turn had a remote equitable interest in Allis. To use estoppel here to argue against a contractually relied upon date as the day for valuation that will "squeeze out" all possible profit is almost to manufacture profit and to render the statute punitive and not remedial.

As indicated above, in 16(b) determinations, the manner in which a corporation handles its financial records and statements for its own or public purposes, and its statements in courts may, like admissions against interest, weigh heavily against such corporation, but the court may not use these facts to abandon its duty of determining the market value. Estoppel will not intervene to bind a party to what otherwise under the facts would be an erroneous determination of artificial profit. *Mueller* v. *Korholz, supra; Park & Tilford, Inc.* v. *Schulte, supra; Champion* v. *Jeffress*, 352 F.Supp. 1081, 1084 (E.D.Mich. 1973).

Earlier in this case, when it was before the District Court for the Eastern District of Wisconsin (the case was later transferred to this district), Judge Reynolds of that court announced that the date of purchase is that on which the "insider" becomes bound and by the act of shareholder approval entitled to acquire the tendered shares. *Allis-Chalmers Mfg. Co.* v. *Gulf & Western Industries, Inc.*, 309 F.Supp. 75, 80-81 (E.D.Wis. 1970). I conclude with him, from all the evidence that July 29, 1968 was for purposes of valuation the date of purchase.

Plaintiff contends that the value of 9/10ths of a G&W warrant expiring in 1978 to acquire a share of G&W's common stock at $55 must be merely 9/10ths of the low at which those warrants were traded on the exchange on the valuation date. When we use the date Allis chose—August 1, 1968—and that day's low—13.875, we come out with a figure of $37,462,500.[3] When we use the date of the rule of this case—July 29, 1968—and that day's low of 15.0, we come out with a figure of $40,500,000.[4] I disagree with both. If an investor is to be ordered to turn over his "profit", without proof of wrongdoing, it should be real and not manufactured profit. The research and reporting services relied upon by the public in the market recite lows and highs to reflect trends, but when reflecting an isolated day in a single figure they use an average. A quick average is half the sum of the high and low. A refined average would be the volume-weighted average for the day. We should use neither the high nor the low if we have the facts from which to make a realistic determination. *Mueller* v. *Korholz, supra; Volk* v. *Zlotoff*, 318 F.Supp. 864, 866 (S.D.N.Y. 1970).

Defendant contends that as to its warrants, we at least should consider their volume-weighted average on July 29th. This average was 15.56301. When we use that average we come out with the figure of $42,020,127.[5] With this I agree. But then, the defendant goes further and urges that a realistic valuation of the warrants would recognize the effect of arbitrage upon the value of the

[3] 9/10ths of 13.875 x 3,000,000; or 9/10ths of 3,000,000 (2,700,000) x 13.875.

[4] 9/10ths of 15.0 x 3,000,000; or 9/10ths of 3,000,000 (2,700,000) x 15.0.

[5] 9/10ths of 15.56301 x 3,000,000; or 9/10ths of 3,000,000 (2,700,000) x 15.56301. Defendant rounded this figure for the average at 15.56, and came out with the lesser amount of 42,012,000.

warrants. This, according to G&W, would require using the weighted-average in the trading of the warrants over the period of May 7, 1968, when public notice was given of the intent to follow through on the exchange offer, and July 29, 1968, the acquisition date. This average was 18.93. Were that average used, we would come out with the figure of $51,120,000; the amount G&W claims to be the proper valuation. With this I do not agree.[6] I am of the opinion that to apply arbitrage would be unrealistic and artificial.

[6] I learn from the witnesses that quite commonly during exchange and tender offers specialized trading comes into play and affects the market price of one or the other of the securities involved, from the time of a market awareness of a proposed exchange or tender offer until the consummation of the transaction.

Generally the proponent of the exchange, the seller, in order to insure the success of his proposal, places in the package he offers as consideration things that would add up to a higher market value than that of the securities sought. This, I am taught by the witnesses, attracts arbitrageurs whose dealing in these securities causes their market prices to be unrepresentative of what they would be even when they reflect the offer. Fair market value thus should reflect an averaging out of the difference between the down pressure of arbitrage activity and the resistance of the security to that pressure.

The defendant strongly urges that statistics show that arbitrage did occur here and that the value of the warrants should take it into account. But the reports of Investment Statistics Laboratory show no changes in the trading and prices of the warrants, at least during the first two months of the exchange offer which could not be attributed to the offer itself. Were arbitrage applicable in this case, it seems to me that to strike an average over the entire period of awareness of the offer when no serious drop in the prices of the warrants occurred until a few weeks before the acquisition date, would give excessive weight to the high as against the low. This indeed would be manufacturing a valuation.

On the other hand, the evidence shows that without any dramatic increase in warrants outstanding from April through July, there was a dramatic increase in short interest over the period of the exchange. The percentage of short interest to outstanding warrants increased from .4 in April to 13.4 in May, and then to 14.7 in June and 18.9 in July. In August it returned to 8.0, in September to 4.5 and in October and November back to .4. When this fact is placed along side the daily trading and closings of the warrants over the same

In 16(b) valuations of the consideration given through exchange offers in payment for the stock of the plaintiff corporations, making adjustments of market value to reflect the impact of arbitrage activities upon securities of one side would deprive the parties of fundamental fairness. G&W would have a windfall of at least $4,981,500.

I find no case law to guide me on this issue, but when I analyse carefully the testimony of the expert witnesses I conclude that in any case in which the purchase is effected through a security for security exchange offer, adjusting the market value of the securities given as consideration for the target securities to reflect the impact upon the market of arbitrage would be improper. To allow G&W an additional cost amount reflecting arbitrage, would be to give G&W compensation for having made the exchange offer.

The effect of the exchange offer itself on the market price, as from day to day while it is open and information and rumors about it change, is as substantial an unknown

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period of time, it becomes clear that there was arbitrage relating to this exchange offer. But it becomes equally clear that it had no effect upon the market of the warrants until on or after July 12th on which day they traded dramatically low and closed at 19.25. Prior to then its closings described no pattern. During the 42 market days from May 7 to July 12, the movements were not unusual. There was a lowest closing at 17.25 on June 28th, and a highest closing at 20.75 on July 8th. But after the 19.25 closing of July 12th there was a meaningful, consistent decline to an all time low of 13.875 on August 1st. It is this decline which would reliably reflect the effect of arbitrage activity.

Were I to give a fair value to the impact of arbitrage upon the market price of the warrants on the date of purchase, I would strike an average between the closing on July 12, 1968, as explained above, and the weighted-average of the trading on July 29, 1968. With that in mind, I would find the fair market valuation of the G&W warrants given as part of the consideration for the Allis common at the time of the purchase to be $46,993,500. (Half the sum of 19.25 and 15.56 is 17.405. 9/10ths of 17.405 x 3,000,000 (or 17.405 x 9/10ths of 3,000,000) (2,700,000) comes out to be $46,993,500.)

as is arbitrage. Both are that speculative in nature that when the proponent of an exchange offer, as here, puts together his package of considerations to pay for the target security, as he is deemed to have placed in it what will insure the success of the exchange, so he must be deemed to have withheld from it what he calculates will be necessary to cover for the aberrations of the market, including arbitrage. Were he, hypothetically, buying up his own package at the time of the exchange, and in the market place, and were he allowed an adjustment for arbitrage, he would benefit from it twice. Just as the court will not construct a valuation to manufacture a higher profit, so it will not permit considerations which, though perfectly fair and proper in other valuations, have the effect of manufacturing an undeserved deduction from profit.

In view of the foregoing, I conclude that the value to be assessed the warrants given as part consideration for the 3,000,000 Allis common shares on July 29, 1968, is $42,020,127.

The third item of the consideration given for each of the 3,000,000 shares of Allis' common stock was a $12.50 principle amount of a G&W 6% subordinated debenture.[7] The debentures were issued in denominations of $100 and for each Allis share one eighth of a debenture was given. There thus were 375,000 of such debentures issued and all were given in the 3,000,000 share exchange. They were new debentures due in 1988. On the date of purchase controlling in this case, July 29, 1968, none of these debentures were traded on the stock exchange. As far as that is concerned, even the August 1st date claimed by Allis to be the proper date of purchase would not serve to give a fair market value to them because there were too few traded upon which a

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[7] The first item was $11.50 cash per share. 3,000,000 x $11.50 = $34,500,000.

fair valuation could be based. On July 29th there were outstanding and being traded in substantial amounts similar debentures due in 1987. On that day $87,000 of them were traded with an average between the high and low of 80.875.

The new debentures were first admitted to trading on the New York Stock Exchange on August 8, 1968. On that day, 332 one thousand dollar units were traded. They opened at 75, closed at 75, had a high of 76, a low of 74, and a volume-weighted average of 75.15023. Both Allis and G&W refer to August 8th for a meaningful valuation. Allis claims the amount should be the low of $74 because, it asserts, "Section 16(b) case law the lowest price of a security on the date of purchase governs." G&W claims that the amount should be the volume-weighted average of the August 8th trading, $75.15 each. None of the experts were able to place a hypothetical or real valuation on the debentures, either as of July 29th or August 1st, based upon knowledge existing as of that day.

To choose the low of August 8th's trading, as requested by Allis, just to "squeeze out all possible profits", is to manufacture valuation. Since similar debentures were trading with a high-low average of 80.875, and since our debentures themselves finished out the rest of August with an average closing of 76.47, the volume-weighted average of the first trading day, August 8th, $75.15 is quite realistic of what would have been the fair market value on July 29th, had there been a market. Accordingly, I find the value of the debentures given up in the exchange offer to be $28,181,336 ($75.15023 x 375,000).

In addition to the 3,000,000 shares of Allis' common acquired by G&W through the Exchange Offer, G&W later purchased 248,000 shares from Oppenheimer Fund, Inc. Their agreement of August 28, 1968, provided that in

exchange for the Allis stock Oppenheimer Fund, Inc. would receive 496,000 G&W warrants. Because the consummation of this agreement depended upon, among other things, the listing of the G&W warrants and underlying common stock to their respective stock exchanges (subject to official notification of the issuance), the agreement called for a closing date three days after such listing but not later than September 30, 1968; and G&W would receive all dividends paid on the Allis shares after the agreement date, August 28th.

Although the G&W warrants would be listed without SEC registration and thus were not freely tradable, G&W agreed to file a registration on or before April 30, 1969. G&W also agreed that if the registration statement did not become effective by December 31, 1968, and if Oppenheimer chose to sell any warrant in the ninety days following the effective date of registration, G&W would guarantee or pay Oppenheimer an average gross price of $13.50 for each warrant Oppenheimer sold. The agreement was closed on September 30th. G&W did not cause the registration statement for the warrants to become effective until January 13, 1969, thus bringing into effect the agreement's price guarantee. On March 18, 1969, Oppenheimer informed G&W of its sale of 8,500 warrants and its plan to sell the remaining warrants beginning after March 21, 1969. The parties however reached an agreement wherein Oppenheimer would defer the immediate sale of the warrants, and G&W would extend the guarantee until October of 1969. On April 18 Oppenheimer invoked the extended guarantee and a week later made its demand upon G&W for $2,154,450. G&W paid it on June 5, 1969.

The parties have agreed that the valuation date of these 496,000 warrants was September 30, 1968. The agreement is realistic and I approve it. These warrants were un-

registered at the time of purchase and their valuation must reflect that fact. On that date registered warrants were traded on a volume-weighted average at $16.11444. The experts were of the opinion that the discount should be between 9.5% and 18%. One figured the discount to be 9.5%. Another's opinion was 15%. Still another chose generally between 13% and 18%. The 15% was based upon the average of the trading in the warrants on September 30. I find it thus the most realistic discount. This would make the fair value of these warrants, there being no market, $13.69.

Placed upon this discounted price must be a value representing the guarantee to register within 3 months. If the warrants were not registered, as agreed, Oppenheimer could sell at what it could get, and in addition charge back against G&W the guarantee premium up to $13.50 per share. Since the guarantee was a penalty obligation, it seems to me that the guarantee of $13.50 and the discount of $13.69 would cancel each other, and leave the valuation to be attributed to the cost to G&W at the market price of September 30, 1968, less the difference between the discount and the guarantee, i.e., less 19¢. I therefore place on this purchase a price of $7,896,320 ($15.92 x 496,000).

From the foregoing, I find that the total purchase price paid by G&W for its purchase of the Allis common acquired through the exchange offer to be $104,701,463 and the purchase price of the total of the 3,248,000 exchange offer and Oppenheimer shares to be $112,597,783.

The Sale

When G&W on December 6, 1968, sold all 3,248,000 of its Allis common to White Consolidated Industries, Inc., it took in exchange $20,000.000 in cash, White's Promissory

Note in the amount of $93,680,000, and 250,000 shares of White's common stock.

Between the parties there is no dispute about the $20,000,000, and little disagreement over the valuation to be given for the 250,000 shares of unregistered White Common Stock. Unlike the unregistered G&W warrants which figured in the contract between G&W and Oppenheimer, wherein a guarantee served to offset the discount, in the receipt by G&W of 250,000 shares of White's unregistered common as part of the sale price of the Allis common stock it had acquired, there was no price guarantee. One of the experts placed the discount at 15.3%, another at from 25% to 30%, and a third at 25%. The first of such expert's testimony was an "Offer of Proof" permitted in evidence, but because of his absence on the witness stand he was not confronted by cross-examination. I agree with the parties that the expert testimony setting the discount at 25% is well documented and convincing. Where the parties differ is whether the discount should be applied to the high of White's common selling on December 6, 1968, or to the volume-weighted average of the stock traded that day. For reasons already I have given and consistent therewith I find that the base figure should be that of the volume-weighted average. On that day there were 111 transactions involving 31,100 shares. The high was 42.50; the low was 39.25. The stock opened at 39.375 and closed at 42.00. The volume-weighted average was 40.6053. I find the fair value to be attributed to the White unregistered common was $7,613,493 ($40.6053 discounted by 25% x 250,000 shares).

The valuation on which the parties differ most dramatically is that to be assigned the largest consideration given G&W by White in its purchase of the 3,248,000 shares of Allis common, White's unsecured, six-month, 8½%

promissory note in the amount of $93,680,000. The note must be valued as of the date it was given, December 6, 1968. The note was paid on March 20, 1969, but on December 6th it was impossible to know whether or not it actually would be paid on or before its due date. 16(b) valuations cannot be determined by hindsight. There are those who say that hindsight can test the accuracy of the earlier determination; but I find this test evidentially incompetent. At most it is a consolation for the one who turned out to have been right, but it can't prove that he was. It is evidence of the nature of the risk inherent in the foresight which is competent to establish the accuracy of the valuation. Of the same non-evidential worthlessness is the fact that after December 6th, G&W twice tried to sell the note and was advised that it could not sell it at anything near par. G&W had accepted the note on December 6th at face value.

Allis further contended that G&W is estopped from claiming any value other than the face amount of $93,680,000 of the note, because of the manner in which in its own and public records it had handled the note. On December 6th, G&W placed the note on its record books kept for internal control at its face amount, in its communications with its stockholders reported the note in its face amount, and did the same thing in its filings with the SEC.

Allis further argues that as a matter of law the intent of the parties to the note as expressed in their contract, which recited the note at its face value, controls valuation as it shall be determined by this Court. As authority for this position Allis cites *Kern County, supra, Bershad* v. *McDonough*, 428 F.2d 693, 698 (7th Cir. 1970), and *Newmark* v. *RKO General. Inc.*, 425 F.2d 348, 357 n.9 (2nd Cir. 1970); and states that such an approach is entirely

consistent with the statutory purpose of squeezing all of the profit out of a short-swing purchase and sale that violates 16(b).

I find that none of the cases cited by Allis in aid of its position on this matter supports it. I already have found that, though a party's handling of valuations in its private and public representations may serve as admissions against interest, estoppel will not serve to relieve the court of its duty to determine a realistic market value.

G&W argues that the note was "commercial paper" as differing from "investment paper", the former marketable only at a discount. It is apparent that because the short life and the size of the note on the one hand, and the nature of its promissor and the size of its interest (two points above the prime bank rate at the time), the note was of a hybrid nature that kept it from fitting comfortably into either of these categories. It seems to me that the disinterested but available third party investor would consider the note as worth something less than face value but certainly not as conventionally discountable "commercial paper". It seems to me, considering a comprehensive evaluation of the opinions of the experts who testified about it, he would, in purchasing it, lower it by some broker-like or cost for placement coefficient of risk below its face value. I am convinced that such adjustment would be closer to half the lowest suggested 10% discount attributed to it as commercial paper.

I was particularly impressed with the testimony of two experts, one a Kenneth V. Zweiner, and the other a Lewis Glucksman. Mr. Zweiner considered the note as "money good", and as a banker, had he been approached on December 6th, would have participated with other banks in purchasing the note at face value. Mr. Glucksman, head of the corporate bond department of Lehman Brothers

which had handled commercial paper in excess of 40 billion dollars during last year, had at the time in question advised G&W that the note was "non financible" and that it would have to be factored at 10% to 15% less than its face amount. During this time Glucksman had personally reviewed White's financial condition and found it "unhealthy".

Mr. Zweiner considered that White had a substantial cash throw off in excess of forty million; that White had a good current ratio (excess of current assets over current liabilities) although it had a heavy debt structure; and that White had a good equity base behind it. Mr. Glucksman considered the note as an "unusual" one and too big for Lehman Bros. There had been telephonic commitments of banks to share in picking up the note (prior to December 6th) up to 50 millions of its face, but these commitments were qualified in that additional banks would have to be retained to handle the balance. The lending market at that particular time was tight; but that meant even the more that institutional type investors furnished an available market for long term interest-bearing secure investments. The excellent testimony of all of the many expert witnesses concerning this note considered comprehensively as stated above, causes me to find the market value of the note on December 6, 1968 to have been 5% off its face value, i.e., $88,996,000.

It follows from all the above that the market value of the total consideration G&W received in exchange for its 3,248,000 shares of Allis' common stock it sold on December 6, 1968 to White Consolidated Industries, Inc. is $116,-609,493.

Costs, Dividends and Interest

Certain collateral matters must be considered which bear upon the question of the amount of profit which the defendant, G&W, must turn over to the plaintiff, Allis: (1) allowable costs incurred in connection with the acquisition and disposition of the 3,248,000 shares of Allis' common stock within the statutory period; (2) the dividends paid by Allis while its stock was being held by G&W; and (3) interest on the profit.

As to the first of these items, the parties have stipulated that G&W's expenses incurred in connection with its exchange offer were $2,874,175.67, and in connection with its acquisition of the 248,000 shares acquired from Oppenheimer were $1,696.33. No evidence was presented regarding these matters other than the stipulation of the parties. In light of all the evidence, I find no reason to question these amounts of expenses presented me by the agreement of the parties. The total of expenses incurred then is $2,875,872.

As plaintiff admits, case law supports the proposition that the expenses of a defendant in performing a purchase or sale are a deduction from profit in 16(b) cases. *Blau* v. *Mission Corp.*, 212 F.2d 77, 81 (2nd Cir. 1954); *Arkansas Louisiana Gas Co.* v. *W. R. Stephens Invest. Co.*, 141 F. Supp. 841, 845, 847 (W.D. Ark. 1956).

The second of these matters arises from Allis' claim that there should be included in G&W's profit the $406,000 dividends which Allis paid on the 3,248,000 shares of common stock while they were in the hands of G&W during the statutory period. Plaintiff relies for this contention on *Western Auto Supply Co.* v. *Gamble-Skogmo, Inc.*, 348 F.2d 736, 744 (8th Cir. 1965), cert. denied 382 U.S. 987, and assumes support for its position in several other cases. I find it difficult to distinguish our case from *Western Auto*

on the facts in order that its rule of law not be dealt with. In neither case was the purpose of the short-swing purchase and sale the making of a special profit from the dividends. If it has a legal message to be followed it is that there is no question about the fact that dividends should be available to the court to be used in situations where the conduct of the defendant was reprehensible—where the acquisition of substantial stock in a company was for the purpose of maneuvering the payment of large dividends—where the dividend itself was the target of stock manipulation.

Courts often have permitted the recovery of dividends when it could be inferred that there was some intended connection between the dividends and the short-swing transaction. *Blau* v. *Lamb*, 363 F.2d 507, 528 (2nd Cir. 1966); *Adler* v. *Klawans*, 267 F.2d 840, 848 (2nd Cir. 1959); *Marquette Cement* v. *Andreas*, 239 F.Supp. 962, 968 (S.D. N.Y. 1965). But any use of *Western Auto* to go beyond this approach is to take a backward step from those cases. I find *Western Auto* now to be of dubious precedential vitality. Its holding was reached without any apparent analysis of any special role which dividends played in the case; and gracefully it was retreated from by the same court three years later in *Petteys* v. *Butler*, 367 F.2d 528, 535 (8th Cir. 1966), cert. denied 385 U.S. 1006 (1967).

Experts in the field look upon anticipated dividends as part of the package for which the consideration is paid when the stock is purchased. In addition, dividends are not an element of profit in the sense that they do not result from the purchase and sale of stock, but rather come from the holding of stock. See 45 Va. L.Rev. 1057, 1060 (1959). In the language of the statute dividends logically are not profit. The statute reaches "*profit realized from the purchase and sale*". Dividends thus are treated by the statute like an operational earning or income. This statutory interpretation reads upon the ordinary thinking about dividends in the market place. Except where they are a matter of special concern, the market price generally is presumed to cover dividends reasonably anticipated. At least to the extent that they regularly are paid, they are considered absorbed in the price paid for the stock.

To permit recovery by Allis of the 12½ cent quarterly dividend involved here would be unconscionable for a further reason. The evidence shows that Allis, in its fighting back at G&W's attempt to gain control of it, on August 9, 1968, nine days after the exchange offer was confirmed, slashed its regular and historic 25¢ quarterly dividend in half. The prospectus on the exchange offer, in reciting the dividend history of Allis, mentioned that in each of the first two quarters of 1968 a cash dividend of 25¢ per share had been declared. Moody's Dividend Record showed a continuous dividend record of 25¢ per quarter from and including the fourth quarter of 1966. It is retributive for Allis to say to G&W, "When we found that you had succeeded in acquiring one third of our stock through your exchange offer, before you could exercise a voice in our control we slashed our dividend in half. This should discourage you from any further attempts to divest us of our management controlled independence. But when you sold short of the statutory six months and made available to us the use of Section 16(b) to squeeze out of you every penny's profit, you gave us the right to get back as a part of 'profit' even the half dividend we paid you." For the Court to join Allis in this retributive approach would be for the Court itself to offend traditional notions of fair play and substantial justice.

Of the same vein must be this Court's response to plaintiff's demand for interest on the amount of the profit from the date of the sale to the time of this decision. If interest

is added it certainly should not continue to the time of decision. This causes the total amount of interest to be measured by periods of time not within the control of the parties. These would vary from court to court, reflecting the different programs of courts in the management of the flow of cases through them. Not even should attorneys feel responsible for increases or reductions of potential awards to their clients because of the necessity for the flow of cases also to reflect necessary adjustments of time to accommodate reasonable uncertainties in professional availability. Litigants themselves should not be discouraged from participating fully in statutorily granted causes of action, either as plaintiffs or defendants, by knowledge that the size of awards will be materially affected by the professional affairs of lawyers and courts.

I am of the further opinion that the concept of interest in 16(b) cases offends logic. Since interest represents "the wages of money (or money measured values) at work", it ought be treated as such. If one wrongfully is deprived of the use of money in which one has a proprietary right, the wrongdoer should return it together with the wages it reasonably could have earned throughout the period its owner could have put it to work. The purchaser of stock of a corporation, issued and outstanding, is not taking from the corporation itself values which the corporation could itself have put to work. It is conceivable that the diving in and out by a short-swing profiteer can injure the corporation. I find no support for the idea that relating the profit to the injury would be measuring comparables. A corporation's relationship to its issued and outstanding stock is fiduciary. When a stockholder transfers his stock to another, the corporation's relationship remains intact. The corporation itself has been deprived of nothing. It is my opinion that Congress in §16(b) did not create in the corporation a new

proprietary right in the stock, as against a stockholder or his successor, whether or not he is a "statutory insider". It created a bounty-like award for the target corporation which, like a public prosecutor, succeeds in bringing the one who violates the statute to answer for his wrongdoing. Its award attaches when it has succeeded. Interest, if any, should attach when and if this judgment order is entered in the plaintiff's favor and against the defendant.

Whether or not this logic is correct and controlling, prejudgment interest should not be awarded, in light of case law. Cases permit interest as a matter to be determined by the Court in exercise of equity only if the defendant's conduct has been reprehensible. The last case on the matter of 16(b) interest today is *Gold* v. *Sloan*, 486 F.2d 300, 353 (4th Cir. 1973).

In *Gold* v. *Sloan* both the majority opinion and the dissent agreed on the issue of interest. They observed that the trial court had allowed interest as a matter of course. The trial court's order had simply said that "interest on the amount of profit is a proper item of damage". Relying upon *Blau* v. *Lehman*, 368 U.S. 403, 414 (1962), the Fourth Circuit stated that:

> "The governing rule is that '* * * interest is not recovered according to a rigid theory of compensation for money withheld, but is given in response to considerations of fairness * * *'. This rule has been followed in recent cases where interest was not awarded upon the showing of 'good faith' on the part of the defendant. Blau v. Lamb (D.C.N.Y., 1965) 242 F.Supp. 151, 161; Volk v. Zlotoff (D.C. N.Y., 1970) 318 F.Supp. 864, 867; Lewis v. Wells (D.C.N.Y., 1971) 325 F.Supp. 382, 387."

The Fourth Circuit said interest would be inequitable because it found in *Sloan* an absence of willfulness in the violation and an unavoidably lengthy proceedings. The Supreme Court in *Blau* v. *Lehman, supra,* ruled by analogy and set by its language the reasoning used by the Fourth Circuit.

For the same reasons, which I here adopt, as well as for the reasons I advance above, I hold that interest is not allowable in this case. Here there has been no showing of wrongdoing by the defendant.

It then appears that only one of these three collateral matters may figure into the profit. It is the expense amount of $2,875,872 incurred in the acquisition of Allis stock. This then would add to the purchase valuations before they are deducted from what is calculated to be the valuation assessed the sale to White Industries.

Recapitulation and Conclusion

To recapitulate, I have found the sale valuations to total $116,609,493. This is made up of the $20,000,000 received in cash by G&W, the $7,613,493 value of the unregistered White common stock received, and the $88,996,000 valuation of the $93,680,000 White Promissory Note accepted by G&W. I have found the purchase valuations to total $115,-473,655, which amount includes the $2,875,872 stipulated with approval of the Court to represent the cost to G&W of engaging in its exchange offer and other negotiations. The total not including the costs, $112,597,783 is made up of three figures: the $34,500,000 cash given as part payment for the exchange offer purchase of the 3,000,000 shares of Allis' common stock, the $42,020,127 valuation placed upon the G&W warrants which went into the exchange offer, the $28,181,336 valuation placed upon the G&W debentures

which also were part of the exchange offer, and the $7,896,320 valuation placed upon the acquisition by G&W of the 248,000 shares of Allis stock acquired from the Oppenheimer Fund. The differences leave a profit by G&W to be accounted for to Allis in the amount of $1,135,838. This Court boasts no competency at simple mathematical computations, wherefore, subject to traditional re-examination of the arithmetic involved, it respectfully addresses to the parties this final determination.

In conclusion, the approach of the Court to this cause has been with an awareness that the corporate form of business enterprise increasingly serves the welfare of our modern society, but that the vitality and the integrity of that form must be protected against its use as a shield for wrongdoing. The statute called upon in this case is by legislative action an attempt on behalf of that society to provide by law that protection. It is an effort to monitor the conduct of those in positions of special knowledge of or control over a corporation's affairs. The business world has long been concerned about the statute itself. Some consider it too loose in its terms because it leaves too broad an area in which the courts may determine its proscriptions. Others also desire its repeal or revision because they consider it too severe. The SEC regards its administration a matter for the courts. Congress left its enforcement to corporate investors and provided therefor the exclusive jurisdiction of the federal courts and their traditional powers in equity. The courts in turn faithfully have sought to maintain the Congressional purpose without abandoning their basic principles of justice and fundamental fairness.

It has been held by the Court that in assessing profit, if any, it must make determinations of valuations as of the time of purchase and sale and in terms of fair market value (or fair value in the absence of market), and that such

valuations must be realistic—not artificial. It has been determined that in 16(b) purchases by exchange offers it would be unfair to take into consideration the fact of arbitrage; and that dividends and interest are improper considerations, but that if a defendant's conduct has been reprehensible, they are available to the Court for consideration to the end that the result be effectively remedial (never punitive).

In conclusion, it has been determined that the defendant, Gulf & Western, considering the size of its purchase, and the facts of its purchase and sale, became a statutory insider, and liable to turn over to the plaintiff its profit from the purchase and sale; but that it did nothing wrong, as far as speculative abuses are concerned. It has been found that judgment should be entered against the defendant, Gulf & Western, and in favor of the plaintiff, Allis-Chalmers, in the amount of $1,135,838.

Accordingly, it is so ordered, adjudged, and decreed.

This Memorandum Opinion and Order shall constitute my findings of fact and conclusions of law.

ENTER:

/s/ JAMES B. PARSONS
James B. Parsons
United States District Judge

Date: January 30, 1974
Date of Revision: March 4, 1974

APPENDIX C

IN THE

Supreme Court of the United States

OCTOBER TERM 1974

No. 74-742

FOREMOST-MCKESSON, INC.,
Petitioner,

v.

PROVIDENT SECURITIES COMPANY,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

MOTION OF ALLIS-CHALMERS MANUFACTURING COMPANY FOR LEAVE TO FILE THE ACCOMPANYING BRIEF AS AMICUS CURIAE IN SUPPORT OF THE POSITION OF THE PETITIONER

Allis-Chalmers Manufacturing Company ("Allis") hereby respectfully moves the Court for leave to file the accompanying brief *amicus curiae.* Attorneys for respondent have indicated that they consent to the motion. The consent of the attorneys for the petitioner in whose behalf this brief is submitted, was refused.

THE DECISION BELOW

The opinion of the Court of Appeals is reported at 506 F. 2d 601 (9th Cir. 1974). The opinion of the District Court is reported at 331 F. Supp. 787 (N.D. Cal. 1971).

The Court of Appeals held that § 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b) (the "1934 Act") did not apply to a purchase and sale of more than 10% of a class of equity securities of Foremost-McKesson, Inc. ("Foremost") which occurred within a period of less than six months, because Provident Securities Company

("Provident") had not been a 10% owner of such securities prior to its purchase. According to the Court, Provident was exempted from § 16(b) liability because it was not the beneficial owner of 10% of the shares of Foremost "both at the time of the purchase and sale."

THE INTEREST OF ALLIS-CHALMERS MANUFACTURING COMPANY

The interest of Allis arises from the fact that it is the plaintiff-appellant in an action currently pending in the United States Court of Appeals for the Seventh Circuit, entitled *Allis-Chalmers Mfg. Co.* v. *Gulf & Western Ind., Inc.*, Nos. 74-1266 and 74-1267 (7th Cir., filed Feb. 12, 1974). In that action the District Court held that Gulf & Western Industries, Inc. ("G&W") had violated § 16(b) of the 1934 Act by reason of the voluntary purchase of 3,000,000 shares or approximately 29% of Allis' common stock in July, 1968 and the sale, less than six months thereafter on December 6, 1968, of that block together with an additional 248,000 shares purchased in September, 1968. Prior to its initial purchase of 3,000,000 shares of Allis' common stock in July, 1968, G&W had not owned any equity securities of Allis.

The question presented in the *Allis-Chalmers* and *Provident* cases is whether a purchaser of securities registered under the 1934 Act becomes subject to § 16(b) at the time he acquires that very interest which makes him a 10% shareholder, or only as to subsequent purchases followed by sales within six months.

QUESTIONS THAT MAY NOT ADEQUATELY BE PRESENTED BY THE PARTIES

In the instant case the respondent Provident was a personal holding company which determined in 1969 to liquidate and dissolve. Although Provident desired to have liquid assets to distribute, when it entered into an agreement with Foremost, Foremost required as a condition to

purchasing two-thirds of Provident's assets that Provident accept in part payment, Foremost convertible debentures to be issued for that purpose. Although Provident preferred to sell its assets for cash alone, "eventually it compromised and accepted convertible debentures, one half of which would be registered as soon as possible after closing so that the stock could be offered to the public." (506 F. 2d at 603).

Pursuant to the purchase agreement, Foremost delivered to Provident at the closing on October 15, 1969, \$4,250,000 in cash and a Foremost debenture in the principal amount of \$40,000,000 which was immediately convertible into common shares comprising more than 10% of Foremost's common stock. This debenture was subsequently split into two debentures in the principal amounts of \$25,000,000 and \$15,000,000. At the same time Foremost delivered a \$2,500,000 debenture to an escrow agent on Provident's behalf. On October 20, 1969 Provident received an additional debenture in the principal amount of \$7,250,000.

To accomplish its purpose of liquidation, on October 21, 1969, Provident entered into an underwriting agreement providing for the sale by it of the \$25,000,000 principal amount of debentures it had received. On October 24, 1969, Provident distributed to its shareholders those debentures not commited under the underwriting agreement and ceased to be a 10% shareholder. On October 28, 1969, at the closing under the underwriting agreement, Provident received a check for \$25,366,666.66 from the underwriters and in return delivered to them the \$25,000,000 debenture (506 F. 2d at 603-04).

It was against this background of Foremost's insistence upon the form which this transaction assumed that the District Court, applying principles of equitable estoppel, said:

"In all its essential details the form of the transaction was insisted upon if not dictated by Foremost, often contrary to the plans and wishes of Provident. If the matter had been handled as Provident wished, this case could never have arisen. To allow Foremost under these circumstances to recover the small profit of Provident (almost miniscule in terms of the total amounts involved) simply by a mindlessly literal application of Section 16(b) would be to perpetuate rather than correct an inequity. This the Court is unwilling to do." 331 F. Supp. 787, 792.

We do not quarrel with the opinion of the District Court, but wish to point out that the *Allis* case presents an altogether different picture, and one in which all of the equities, unlike the *Provident* case, are on the side of the issuer (Allis), whose shares were the subject of the short-swing trading. In the *Allis* case, G&W, a major conglomerate corporation, voluntarily and in furtherance of its own plans and pursuits, purchased 3,000,000 shares or over 29% of a publicly traded security (the common stock of Allis) and four and one-half months later voluntarily sold it along with 248,000 additional shares acquired after the initial purchase.

In January, 1969, Allis commenced suit under § 16(b) to recover the profits realized by G&W as a result of its short-swing trading in Allis shares. After trial without a jury the District Court found that G&W, following its initial purchase of 3,000,000 Allis shares, was in a position to obtain inside information "had it wanted to." *Allis-Chalmers Mfg. Co.* v. *Gulf & Western Ind., Inc.*, 372 F. Supp. 570, 579 (N.D. Ill. 1974). It went on to hold that when G&W sold those shares within six months it violated Section 16(b) of the 1934 Act, and was required to account for the profits realized. *Id.* at 591.*

* Allis appealed from the District Court's determination of the amount of profits realized by G&W. G&W cross-appealed with respect to the issues of both liability and profits.

It is Allis' position that the voluntary purchases and sale of publicly traded securities involved in its case are far more common and likely to recur than the highly unusual set of transactions involved in *Provident*. It is also Allis' position that the very situation involved in its case, the voluntary purchase of a large block of securities followed by access to inside information and a sale thereof within a six month period, was precisely the situation intended to be covered by § 16(b). As a consequence, Allis is concerned that the important issue involved in the *Provident* case *not* be analyzed solely within its unusual factual context, but only after full consideration of its effect on the more typical fact pattern which the *Allis* case presents.

Therefore, we respectfully urge that Allis' motion be granted so that this Court will have before it the totally different factual situation presented in that case which will be affected profoundly by the result in *Provident*.

April 18, 1975

Respectfully submitted,

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BRIEF IN SUPPORT OF THE POSITION OF THE PETITIONER

JURISDICTION

The judgment of the Court of Appeals was entered on September 19, 1974. The petition for a writ of certiorari was filed on December 16, 1974 and was granted on February 18, 1975.* The jurisdiction of this Court rests on 28 U.S.C. § 1254(1).

QUESTION PRESENTED

Whether the purchaser in a single transaction of more than 10% of the equity securities of an issuer, who theretofore has owned none of said securities but within six months sells the entire block, is liable under § 16(b) of the 1934 Act to return to the issuer any short-swing profits realized?

STATEMENT

We accept and will not repeat the statements of the case as set forth by both the petitioner and respondent in their briefs filed in connection with the petition for writ of certiorari.

STATUTE INVOLVED

Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78p(b) (the "1934 Act"), provides in pertinent part:

> "For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months,*** shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection."

* We understand from counsel for Provident that in their brief they intend to take the position, as they did before the District Court and Ninth Circuit, that § 16(b) is inapplicable to the transaction at issue because the transactions involved were without potential for speculative abuse. *See Kern County Land Co.* v. *Occidental Petroleum Corp.*, 411 U.S. 582 (1973).

ARGUMENT

I

The Cases And Policy Of § 16(b) Require That The Words "At The Time Of" Be Construed To Cover The Initial Transaction By Which A Shareholder Aquires His 10% Interest

The opinion of the Ninth Circuit in the *Provident* case accords with no other Circuit or District Court* which

* *Arkansas-Louisiana Gas Co.* v. *W.R. Stephens Inv. Co.*, 141 F. Supp. 841 (W.D. Ark. 1956), is the lone District Court case which supports the result of the Ninth Circuit. It has been overruled, *sub silentio*, by *Emerson Electric Co.* v. *Reliance Electric Co.*, 434 F. 2d 918 (8th Cir. 1970), *aff'd on other grounds*, 404 U.S. 418 (1972).

has been faced with the precise issue of the applicability of § 16(b) to an initial purchase by which the purchaser becomes a more than 10% beneficial owner of securities followed by a sale within less than six months. *See, e.g., Emerson Electric Co.* v. *Reliance Electric Co.*, 434 F.2d 918, 922-24 (8th Cir. 1970), *aff'd on other grounds*, 404 U.S. 418 (1972); *Perine* v. *William Norton & Co.*, 509 F.2d 114, 118 (2d Cir. 1974); *Newmark* v. *RKO General, Inc.*, 425 F.2d 348, 355-56 (2d Cir.), *cert. denied*, 400 U.S. 854 (1970); *Stella* v. *Graham-Paige Motors Corp.*, 104 F. Supp. 957 (S.D.N.Y. 1952), *aff'd in part, remanded in part on other grounds*, 232 F.2d 299 (2d Cir.), *cert. denied*, 352 U.S. 831 (1956).

Moreover, this Court itself has indicated in its most recent decision involving § 16(b), *Kern County Land Co.* v. *Occidental Petroleum Corp.*, 411 U.S. 582, 584 (1973), that

> "Unquestionably, one or more statutory purchases occur when one company, seeking to gain control of another, acquires more than 10% of the stock of the latter through a tender offer made to its shareholders."

and that

> "By May 10, 1967 Occidental had acquired more than 10% of the outstanding shares of Old Kern. It was thus a statutory insider when, on May 11, it extended its tender offer to include another 500,000 shares." *Id.* at 598.

Without question, it would not have been necessary for this Court to reach the issue as it did in that case of whether Occidental had made a "sale" for purposes of § 16(b) had it not first determined that in acquiring its initial more than 10% interest in Old Kern, it had made a § 16(b) "purchase".

Most importantly, the result in *Provident* is directly contrary to the Congressional purpose and the policy of § 16(b) of preventing the possibility of abuse of inside information which may be obtained by a class of insiders solely as a result of its relationship to the issuer. Further it impairs severely the protections § 16(b) provides the investing public by supplying an easy mode of evasion and insulation from liability for large shareholders such as G&W who have the requisite access to confidential information solely by virtue of their large stock holdings. *See, e.g.*, 2 L. Loss, SECURITIES REGULATION 1060 (2d ed. 1961) (". . . it is difficult to quarrel with the [Second Circuit's] preference for the construction which would serve to effectuate the legislative purpose and still leave some meaning for the statutory language when there is an ambiguity . . .") and Cook & Feldman, *Insider Trading Under the Securities Act*, 66 Harv. L. Rev. 612, 631-32 (1953).

In the recent case of *Emerson Electric Co.* v. *Reliance Electric Co.*, 434 F.2d 918 (8th Cir. 1970), *aff'd on other grounds*, 404 U.S. 418 (1972), Emerson purchased 13.2% of the outstanding common stock of Dodge Manufacturing Corporation on June 16, 1967. It owned no stock of Dodge at the time of this single purchase. Dodge thereupon arranged a defensive merger with Reliance. Emerson, faced with the prospect of a forced exchange of its Dodge shares for stock in the merged corporation, took steps to mitigate its § 16(b) liability by selling, on August 28, 1967, 37,000 shares—or 3.24%—of the outstanding stock of Dodge, thereby reducing its holdings to 9.96% of the outstanding stock.

In determining whether the purchase by which Emerson became a more than 10% shareholder subjected it to § 16(b), the Eighth Circuit held:

> ". . . we have concluded that the purchase by which a security holder acquires a more than 10 percentum status is included as a part of a pair of transactions of purchase and sale occurring within six months of each other within the meaning of Section 16(b). Any other view has the weakness of impracticability of application of the statute, a result we should not lightly attribute to a Congress striving to prevent what it considered to be highly undesirable speculations by certain security owners who are in position to obtain or to be exposed to that kind of inside information lending itself to speculative use to the possible detriment of the public." 434 F.2d at 924.

The issue of whether Emerson's purchase of 13.2% of the outstanding stock of Dodge—at a time when Emerson did not own any Dodge stock—brought Emerson within the reach of § 16(b) was not before this Court on appeal and this Court expressly declined to decide it. However, with regard to Emerson's step sales, this Court held that the language of § 16(b) "at the time of the purchase and sale" meant exactly that and thus the second sale, effected while the defendant was the holder of less than 10% of the issuer's stock, was not intended to be covered by § 16(b).

In approving the technique of the step sale transaction by a beneficial owner of more than 10% of the outstanding stock of a company, this Court indicated that the Statute does not foreclose the possibility of the mitigation of damages by step sales. Similarly, it can be said that the exemption "both at the time of the purchase and sale," requires no different interpretation with respect to "stepped up" purchases of the stock of an issuer . Thus for example the purchaser of 9% of the securities of an issuer who shortly thereafter makes a second purchase of an additional 2% or

3% of those securities becomes subject to § 16(b) only on the occasion of the second purchase.* Here G&W in acquiring and disposing of more than 29% of the shares of Allis in one purchase and one sale is not entitled to an exemption for either a "stepped up" purchase or a "stepped down" sale. G&W's conduct was precisely the kind of conduct that § 16(b) prohibits.

Stella v. *Graham-Paige Motors Corp.*, 104 F. Supp. 957, *aff'd in part, remanded in part,* 232 F. 2d 299 (2d Cir.), *cert. denied,* 352 U.S. 831 (1956), was the first case in which a court was required to grapple with the meaning of the "at the time of the purchase and sale" language of § 16(b). In that case, Graham-Paige, the owner of 6¼% of the outstanding shares of Kaiser-Frazer Corporation, purchased in a single transaction a sufficient number of shares to increase its holdings to 21% of all the outstanding stock. Less than six months later, Graham-Paige sold part of its holdings, and suit was brought to recover profits under § 16(b) of the 1934 Act. On its motion for summary judgment, Graham-Paige contended

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* This Court in *Emerson,* 404 U.S. at 423 n. 3 cites with approval 2 L. Loss, SECURITIES REGULATION 1060 (2d ed., 1961) with respect to step sales. The full text covers both step purchases and step sales.

> "A substantial 'out' nevertheless remains for the 10 percent holder: If a person who is not an insider wants to acquire up to, say, 15 percent, he should buy up to just under 10 percent in one transaction (which will be exempted even under the court's construction [in *Stella* v. *Graham-Paige Motors Corp., infra*]) and then buy the remaining 5-plus percent in a separate transaction. Conversely, a person who owns 15 percent and wants to sell down to 5 percent should sell 5-plus percent in one transaction and then, after he becomes a holder of slightly less than 10 percent, sell out the remainder."

that the purchase and sale involved in the action were exempt from § 16(b) because it was not the beneficial owner of more than 10% of the Kaiser-Frazer stock both at the time of the purchase and sale.

The Court determined that the Congressional purpose underlying the enactment of § 16(b) was clear. Congress intended to protect outside stockholders against short-swing speculation by insiders with advance information and thus:

> "If the construction urged by defendant is placed upon the exemption provision, it would be possible for a person to purchase a large block of stock, sell it out until his ownership was reduced to less than 10%, and then repeat the process, ad infinitum. A construction such as this would provide a way for the evasion of § 16(b) by principal stockholders, and render it largely ineffective to prevent some of the financial evils which led to the passage of this legislation by Congress." 104 F. Supp. at 959.*

The Court then held that if the words of § 16(b) "at the time" were construed to mean "simultaneously with" rather than "prior to" the purchase by means of which a shareholder becomes 10% beneficial owner,

> ". . . a shareholder would become subject to the provisions of § 16(b) as soon as his ownership exceeded 10% of the outstanding shares. This construction would be consistent with the declared purpose of the statute to prevent the unfair use

* The Ninth Circuit attempts to resolve this problem by claiming that § 16(b) would be applicable to an initial 10% or better purchase if such purchase is in effect a "repurchase" 506 F. 2d at 614-15. It is submitted that the framers of § 16(b) had no intention of establishing two separate and inconsistent applications for the Statute. Further, such an interpretation conflicts with the objective approach to the meaning of the language of § 16(b) taken by this Court in *Reliance Electric Co.* v. *Emerson Electric Co.*, 404 U.S. 418 (1972).

> of inside information by officers, directors, or stockholders owning more than 10% of the equity stock." 104 F. Supp. at 960.

It is Allis' position that the statutory language and the remedial purpose sought to be achieved by the enactment of § 16(b) support the contention that the statute is applicable simultaneously with the purchase by which one becomes a more than 10% beneficial owner of an issuer's securities. We submit that for this Court to affirm the *Provident* case would be to erase much of the protection now offered the investing public by § 16(b). The view of § 16(b) espoused by the Ninth Circuit would permit untrammeled speculation by large security owners who are in a position

> ". . . to obtain or to be exposed to that kind of inside information lending itself to speculative use to the possible detriment of the public." *Emerson Electric Co.* v. *Reliance Electric Co.*, 434 F.2d 918, 924 (8th Cir. 1970), *aff'd on other grounds*, 404 U.S. 418 (1972).

We urge that such a position not be adopted by this Court.

II

The Legislative History Of § 16(b) Relied Upon By The Ninth Circuit In Its Opinion Cannot Withstand Close Scrutiny

In its opinion, the Court of Appeals for the Ninth Circuit extracts from the legislative history of § 16(b) evidence of a non-existent Congressional intent.* To reach this result, the Court relies on the testimony offered in

* It should be noted that this Court determined that "the legislative history affords no explanation of the purpose of the proviso". *Reliance Electric Co.* v. *Emerson Electric Co.*, 404 U.S. 418, 424 (1972).

hearings held only in connection with the following version of § 16(b):

> "(b) It shall be unlawful for any director, officer or owner of securities, owning as of record and/or beneficially more than 5 per centum of any class of stock of any issuer, any security of which is registered on a national securities exchange—
>
> (1) To purchase any such registered security with the intention or expectation of selling the same security within six months; and any profit made by such person on any transaction in such a registered security extending over a period of less than six months shall inure to and be recoverable by the issuer, irrespective of any intention or expectation on his part in entering into such transaction of holding the security purchased for a period exceeding six months." S.2693 (H.R. 7852), 73d Cong., 2d Sess. (1934).

On the basis of this single draft, the Ninth Circuit concludes that § 16(b) was

> ". . . originally designed to deter insiders from purchasing stock without any intention of making a long-term investment, but only with the intention of profiting from upward fluctuations in the market price that were predictable on the basis of inside information. The section was directed against an insider who has no intention of changing his investment relationship to the corporation, but rather has an 'intention or expectation' to purchase and sell the stock within six months. After the pair of transactions is completed he intends to own exactly the same interests in the corporation as he owned before he began his speculative venture." (506 F. 2d at 609)

The Ninth Circuit, however, has neglected a vital fact in its analysis of the legislative history of § 16(b). The language upon which the Court predicates its conclusion is

drawn from a Senate bill (S. 2693) which never became law—a bill which in fact never received a single vote on the floor of either house of Congress. The present language of § 16(b) can be traced to a different bill (H. R. 8720), which was introduced in the House of Representatives almost a month *after* the hearings quoted and erroneously relied upon by the Ninth Circuit. The new bill reflected several major changes from the prior version, but most important for our purposes, was its elimination of the language that would have tended to limit its application to transactions involving shareholders with pre-existing 10% holdings.

The legislative history gives no indication whatsoever of the reason for deletion of the language relied on by the Ninth Circuit. That Court speculates that this change was made to "ameliorate this difficulty of *proving* intention or expectation" (506 F. 2d at 611; emphasis added), but not to "alter the section's goal of deterring insiders from speculating on the basis of inside information obtained because of 'substantial stockholdings' ". (506 F. 2d at 610).

This explanation, however, is unsatisfactory. It is clear from a review of all of the draft proposals for § 16(b) (see S.2693, H.R. 7852, H.R.8720, S.3420 and H.R. 9323, 73d Cong., 2d Sess. (1934), that *all* were intended to create an irrebuttable presumption of intent, to be inferred solely from the fact of a short-swing purchase and sale. *See, e.g.*, Hearings on S. Res. 84, S. Res. 56 and S. Res. 97 Before the Sen Comm. on Banking and Currency, 73d Cong., 2d Sess., pt. 15, at 6554 (1934) (hereinafter 1934 *Hearings*). Thus, the deletion of the "intention or expectation" language had no effect on the burden of proof.

Still less satisfactory is the Ninth Circuit's curious assumption that by eliminating language which would have

limited the scope of the new law, Congress intended to preserve precisely that limitation. The logical inference is quite the contrary—that Congress intended to *broaden* the bill. Such an extension would be consistent with the contemporaneous change to proscribe sales followed by short-swing purchases as well as purchases followed by short-swing sales.

In view of Congress' silence on this point, the only thing that can be said with any real certainty is the language upon which the Ninth Circuit premises its reading of Congressional intent was deleted in its entirety from the bill *before* passage by either House, and cannot by its absence limit the intended scope of the bill that *was* passed.

Clearer evidence that Congress *did* intend to bring within the ambit of § 16(b) shareholders who acquire their 10% interests *without* having had a prior relationship to the issuer, can be found in the concern expressed during the hearings on the House draft (which is substantially similar to the version of § 16(b) which was enacted) that the section:

> ". . . might prevent arbitrage transactions, because it is very common, in arbitrage, for a man to buy one security and at the same time sell against it an equivalent security. While that process of the arbitrage is going on he might conceivably accumulate more than 5 percent of this security, and he would, of course, be the beneficial owner of that 5 percent. He would, of course, have offsetting contracts or obligations against it, but they are not reflected in the definition which imposes penalties on a stockholder owning 5 percent or more of a registered security." 1934 *Hearings* at 7567 (Statement of Roland L. Redmond, Attorney for the New York Stock Exchange, on S. 8720).*

* The bill as enacted increased the requisite holding from 5% to 10% of the issuer's equity securities.

At the hearing, it was suggested to the Congress that the above problem (which would not arise if the position of the Ninth Circuit were correct) could be remedied by providing at the foot of the bill a provision enabling the commission charged with enforcing it to exempt arbitrage transactions from the force of the Section (1934 *Hearings* at 7567). However, Section 16(e), included in the text of the bill itself, provided *precisely* such an exemption. Moreover, § 16(d) expressly exempted from § 16(b):

> "any purchase and sale, or sale and purchase, . . . of an equity security *not then or theretofore held by him in an investment account*, by a dealer in the ordinary course of his business and incident to the establishment or maintenance by him of a primary or secondary market . . . for such security". (emphasis added).

Both of these express provisions are strong evidence that Congress intended to cover by § 16(b) that very transaction making a stockholder a 10% stockholder, for if Congress' thought otherwise, neither exemption would have been necessary.

Another provision suggested by witnesses at the hearings, that the administrative body charged with enforcement be empowered to exempt certain transactions, is included in the text of § 16(b) itself:

> "This subsection shall not be construed to cover . . . any transactions which the Commission by rules and regulations, may exempt as not comprehended within the purpose of this subsection."

Pursuant to this authority, the SEC has by Rule 16b-2 (17 C.F.R. § 240.16b-2) exempted from the embrace of § 16(b) certain transactions engaged in by underwriters. Clearly no such rule would have been necessary if the Section means what the Ninth Circuit has held it to

mean. Moreover, the existence of such a rule is strong evidence that the SEC interpreted § 16(b) as otherwise applicable to such a transaction. See *Perine* v. *William Norton & Co.*, 509 F. 2d 114 (2d Cir. 1974).*

In summary, the legislative history, to the extent that it bears upon this issue, supports the conclusion that Congress intended to include in the proscriptions of § 16(b) all acquisitions of stock which have the effect of carrying the purchaser's ownership above the 10% mark. Accordingly, we respectfully urge that the Ninth Circuit's erroneous view as to Congress' intent not be accepted by this Court.

CONCLUSION

We respectfully submit that this Court should not affirm the judgment below on the grounds expressed by the Ninth Circuit in its opinion.

April 18, 1975

Respectfully submitted,

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* Interpretive rules and practices of the agency charged with the administration and enforcement of a statute are accorded authoritative weight. *See, e.g., Bowles* v. *Seminole Rock Co.*, 325 U.S. 410, 414 (1945); *Commissioner* v. *Estate of Sternberger*, 348 U.S. 187, 199 (1955).

IN THE

Supreme Court of the United States

OCTOBER TERM 1975

No. 75-580

ALLIS-CHALMERS MANUFACTURING COMPANY,
Petitioner,
v.
GULF & WESTERN INDUSTRIES, INC.,
Respondent.

BRIEF FOR RESPONDENT IN OPPOSITION

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IN THE

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OCTOBER TERM 1975

No. 75-580

Allis-Chalmers Manufacturing Company,
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Respondent.

BRIEF FOR RESPONDENT IN OPPOSITION

Gulf & Western Industries, Inc. ("G&W") submits this memorandum in opposition to the petition for a writ of certiorari filed by Allis-Chalmers Manufacturing Company ("Allis") on October 16, 1975. Because of the Court's current review of *Foremost-McKesson, Inc.* v. *Provident Securities Co.*, No. 74-742, which involves the same issue on different facts, G&W does not believe it appropriate formally to oppose the granting of such petition, but does oppose the arguments made and result sought by petitioner, and it submits that the holding below should be summarily affirmed.

Moreover, we submit that the writ may properly be denied and the decision below left to stand because the circumstances of the instant case differ significantly from those in the *Foremost-McKesson* case, and the decision below was correctly decided as to liability. G&W was an undisputed "outsider" when it acquired its Allis shares, did so in an Exchange Offer involving extensive federal

regulation and disclosure, was treated by Allis as an "undesirable suitor" and "unwanted mate", and sold only after extensive disclosure was again made. No abuse of inside information did occur or possibly could have occurred, and the statutory purpose cannot be served by the imposition of liability. The result below should stand in any event.

G&W also proposes to file a petition for a cross-writ of certiorari to review a different aspect of the decision below concerning valuation within the time allowed.

Restatement of the Question Presented[1]

Whether the purchase by which an outsider—which has no prior relationship to the issuer and never becomes an officer or director—acquires more than ten percent of a class of such issuer's securities must be included as a § 16(b) transaction, despite the statutory proviso mandating that § 16(b) "shall not be construed" to cover such a transaction, where the acquisition was preceded by full disclosure as to the issuer's financial condition and where there was "no possibility under the facts of this case" (*5a*) that such outsider could have used inside information in its acquisition.

Restatement of the Case

Petitioner omits so many facts relevant to the decision below that it is necessary to submit this counterstatement.

1. Pursuant to Rule 21, G&W has requested the Clerk of the Court of Appeals for the Seventh Circuit to transmit the printed joint appendix, agreed upon by both parties for use in the court below, to this Court. Citations in the text in the form: "(5a)" are to the joint appendix; other citations are to trial exhibits not included in the appendix. Because petitioner has chosen a form of pagination for its appendix to the petition which is identical to that of the joint appendix, we have distinguished the two citations by using italics for citations to petitioner's appendix, *e.g.*, "(*5a*)".

A. Background of the Exchange Offer

In early 1967 Allis' earnings dropped sharply (636a-37a) and the decline continued into 1968 (610a, 641a, 1132a). Allis became involved in several announced merger attempts which, however, were abandoned because of discouragement by Allis' management or apprehension of business risks. (Dx-JJJJ-1, at 16, 18-25). A California investment firm, claiming unhappy Allis shareholders as clients, encouraged G&W to seek an interest in Allis (315a). On May 6, 1968 Charles G. Bluhdorn, G&W's chairman, and David N. Judelson, G&W's president, advised Allis' then chairman, Robert S. Stevenson, that G&W was contemplating an exchange offer for Allis and would keep Allis informed (317a, 588a-89a, 1316a-19a; Dx-JJJJ-1 at 29-30). Bluhdorn affirmed to Stevenson that G&W sought no control of or directorships in Allis (*id.*, 30-31, 34).

On May 7 Bluhdorn told Stevenson that disclosure rules required G&W to announce the Exchange Offer immediately, and pointed out that Allis' financial statements would be required for the offering Prospectus. Stevenson said Allis would cooperate (319a, 592a, 1317a, Dx-JJJJ-1 at 39-41), but pressed Bluhdorn again to confirm that G&W sought no merger or control. (592a-95a, 1317a-19a, 1400a-02a, Dx-JJJJ-1 at 41-42). That day G&W announced that pursuant to a Registration Statement it would make an Exchange Offer to all Allis shareholders to acquire up to 3,000,000 Allis shares on a pro rata basis, offering in exchange for each share:

(a) $11.50 in cash;

(b) $12.50 principal amount of 6% G&W Subordinated 20-year debenture due 1988 (the "G&W 6% Debenture"); and

(c) 9/10 of a 10-year G&W Warrant to purchase G&W common stock at $55 per share (the "G&W Warrant")

(593a, 1400a-01a), and this was immediately carried on the Dow Jones "broad tape" (1402a).

B. G&W's Effort to Provide Full Disclosure in the Exchange Offer

G&W's counsel on May 10 requested the cooperation of Allis' general attorney in preparing the Exchange Offer Registration Statement and Prospectus, as required by SEC rules to provide full disclosure of Allis' current condition[2] (1430a). Stevenson was so advised, and on May 17 Allis replied that it would "do anything within reason to cooperate in furnishing material for such registration statement" (1405a), and alerted its independent accountants (1407a). Counsel for Allis, G&W and several investment bankers conferred continually and scheduled a disclosure conference at Allis' headquarters for June 20 (526a-27a, 1547a).

On June 14 Stevenson arranged a meeting with Allis' officers and counsel to precede the disclosure meeting (1547a). Then, on his own initiative, he went to G&W's headquarters on June 18 and saw Judelson, in Bluhdorn's absence (609a; Dx-JJJJ-1 at 60). He said that he told Judelson only by way of an unspecified, numberless "inkle" that the "direction" of Allis' "earnings" was "downward" (610a-11a; Dx-JJJJ-1 at 61).[3] He explained that he visited G&W because he knew G&W was preparing disclosure documents and "didn't want any omissions or overstatements" (659a-60a; Dx-JJJJ-1 at 61-62), but used the opportunity to discourage G&W's acquisition (Dx-YYY at 14-16; 611a; Dx-JJJJ at 61-65).

2. SEC Rule 409, 17 C.F.R. § 230.409; General Instruction F to SEC Form S-1, 2 CCH Fed. Sec. L. Rep. ¶ 8006 at 7016. G&W offered to and did reimburse Allis for all its fees and expenses in connection with disclosure. The information regarding Allis was to appear in other registration statements for other transactions, and a number of other investment bankers' counsel were therefore very concerned with the propriety of disclosure (1408a).

3. Afterwards, Stevenson claimed he got his impression from what he called a "grid", which was at no time mentioned or shown to anyone at G&W (656a, 675a).

At the June 20 disclosure meeting Allis' representatives and counsel for G&W and the investment firms cooperated in securing and reviewing detailed information concerning Allis and formulating language to convey the information fully in the Prospectus (538a-39a). Allis' management and counsel critically reviewed the Prospectus disclosure (543a-44a). Allis' counsel cautioned management that all current statements "must be true on the effective date" and urged a "careful review" to ensure "accuracy and completeness" (1409a).

It was undisputed that G&W published all the material facts about Allis' business and financial condition in the Prospectus (1123a-41a) under the title "Information Concerning Allis-Chalmers". Indeed the Prospectus included Allis' projection of second quarter earnings (702a, 1132a) and noted certain adverse cost and price trends in 1967 which continued to affect its earnings in 1968 (*id.*).

Allis' management "decided that the disclosure had been very complete" (616a), and took no position on G&W's offer, because the Prospectus would give "all of the Allis-Chalmers stockholders . . . all the facts and figures" (651a). G&W representatives had no information about Allis other than that published in the press and in the Prospectus (319a-20a, 1482a-87a). Allis' management, lawyers and accountants each gave G&W formal written assurance that the Prospectus disclosure, as furnished by Allis, was complete and accurate in all material respects. (1421a-24a; 697a; 1425a).

C. The Exchange Offer and Continuing Disclosure

The Prospectus became effective June 1, 1968 (1031a-1142a) and was mailed by Allis to every Allis shareholder

at G&W's expense. The offer was subject to G&W shareholder approval at a meeting set for July 29, 1968, pursuant to a proxy statement setting forth the material on Allis (1018a-29a). Pursuant to the Prospectus G&W would accept up to 3,000,000 shares, pro rata up to July 19, and thereafter in order or receipt (1033a).

Disclosure continued throughout the offer. On July 5 Allis announced that its 1968 first half earnings would be substantially less than in 1967 (1433a-34a). G&W reaffirmed its offer despite Allis' decline, stating it sought a long-term investment (1436a). On July 16 Allis released half-year earnings of 45¢ (down from 81¢ in the first half of 1968).

Response to the Exchange Offer was quick and positive. By July 19 well over 3,000,000 shares had been properly tendered (1442a, 1459a). G&W's shareholder meeting on July 29 approved the offer, despite Allis' recurring setbacks, and thereby gave G&W for the first time more than 10% ownership of Allis' common stock (1145a).

D. Allis' Isolation of G&W Subsequent to the Exchange Offer

Allis' treatment of G&W was described in its own brief to the trial court: "No enterprise which finds itself the object of an undesirable suitor", it said, "need adopt an attitude of friendliness toward the unwanted mate."[4] This confirmed G&W's own apprehension of an "iron curtain of silence" following the Exchange Offer (323a). No G&W representative ever served as a director or officer of Allis, nor did G&W have any voice in Allis' management (662a-63a; 671a). On August 7 Allis slashed its regular quarterly dividend from 25¢ to 12½¢, as part of "its fighting" of G&W (*69a*). G&W had no warning of, and no participation in, the decision (622a-23a; 321a, 671a). Stevenson told Bluhdorn concurrently with public an-

4. Allis Post-trial Brief, Part II, May 14, 1973, at 27.

nouncement that there would be no advance discussion on such matters, because disclosure rules barred discussion "outside of a board of directors room" (615a).

On August 6 Mr. Bluhdorn had telephoned Mr. Stevenson to renew G&W's offer of technical assistance by suggesting that a G&W manufacturing vice-president, recognized by Allis as very capable, visit and assist in any way deemed convenient (321a, 613a). Upon his arrival on August 12, Allis gave him a "stockholder's tour of one of the facilities" (Dx-YYY at 11) and told him in effect that Allis would "like to be left alone . . . to mind their own business" (321a). G&W sent no further representatives.

On August 14 Bluhdorn was called by a Milwaukee newspaperman regarding a press conference called by Allis (321a-22a). Bluhdorn was ignorant of it and, not wishing to appear "foolish", telephoned Stevenson (321a-22a), but Stevenson said that "the information is not available to any one this evening" (618a). The next day, concurrent with "broad tape" announcement, Stevenson telephoned Bluhdorn, saying that Allis had just appointed a new president (323a). G&W had no part in any discussions regarding a new president (323a, 662a) and was never informed of Allis' search for one (619a-20a) because Allis viewed this as an "internal matter" which "should be kept to the board of directors and the management" (619a-20a).

E. Oppenheimer Purchase and the October 21 Press Release

G&W entered into an agreement (1154a-62a) with Oppenheimer Fund, Inc. ("Oppenheimer"), dated August 28, 1968, to acquire 248,000 Allis shares in exchange for 496,000 G&W Warrants and a price guarantee. Its consummation depended upon the satisfaction of certain conditions no later

than September 30, 1968, and the closing was held on that date.

Prior to the Oppenheimer closing, Stevenson came to New York on September 13, 1968 to see Bluhdorn and Judelson. On the eve of the Exchange Offer, the FTC had advised G&W and Allis that it intended to commence a formal proceeding to examine the effect of the proposed acquisition under the antimerger laws (1023a; 1469a). Bluhdorn complained that Allis' "planning department" was purposely misleading the FTC by asserting that Allis proposed to enter businesses similar to G&W's (328a-29a) although Allis' financial condition made such plans unrealistic (636a-37a, 1132a, 1441a, 1478a-80a, Dx-YYY at 23-25, 27-28). Stevenson denied this (622a), but parried the suggestion that Allis might invite Judelson to become a director by suggesting that the FTC would disapprove (625a). Although this was the first time he had met Bluhdorn, Stevenson concluded Bluhdorn was getting "nervous" (625a). To Judelson it was clear that Bluhdorn was "entirely frustrated" by the "ridiculousness of Allis-Chalmers going into ventures that would cost them two or $300 million . . . frustrated . . . not by their full cooperation with the [FTC] but by the mentality that would say you're going to do this sort of thing" (147a).

Stevenson said that during this meeting he gave G&W an unquantified "inkle" about Allis' continuing decline (622a). But according to Judelson, Stevenson never told G&W "anything" about Allis' affairs (1479a) and Bluhdorn's testimony was the same (323a, 334a). Critically, Stevenson's notes of the meeting, bearing the notation "major points" (1330a), contain no mention that Allis' performance was discussed at all, and Stevenson so admitted (663a-65a, 1330a, 1545a-46a). Because of this, along with Stevenson's uniform isolation of G&W from Allis' internal

processes (593a-95a, 597a, 613a, 615a, 618a, 662a, 671a) and other serious testimonial inconsistencies,[5] the trial court found that the substance and purpose of Stevenson's conversation was to "discourage G&W's retention of its stock position in Allis" (*48a*).

Subsequent events further belied Stevenson's recollection of the September 13 meeting, and made it irrelevant. On October 21, Stevenson met with Bluhdorn and others to advise G&W "at precisely the same time that the rest of the world and his shareholders were being informed" (330-31a, 628a-31a, 667a) that the "broad tape" was carrying Allis' projection of a $50 million loss in 1968 from both operating results and write-offs (330a-33a, 628a-29a, 667a). Far from being forewarned, this hit Bluhdorn "like a thunderbolt" (330a), and Stevenson conceded that G&W's officers were completely unprepared and "floored" (668a). The October 21 announcement appeared widely in the press along with detailed information on Allis' earnings prospects (702a-03a, 1494a-1503a). There were no other meetings, and G&W sold no Allis shares until well after the October 21 public announcements.

F. G&W's Sale of Allis Stock

Press reports of Allis' October 21 announcement indicated that G&W had received inquiries to purchase its Allis

5. Apart from the disparity between his careful notetaking and his testimony, Stevenson, who took early retirement in March 1969 (630a-31a), did not always remember to include the portion about giving an "inkle" in the September 13 conversation (1545a-46a), and had to be reminded of it by counsel (Dx-JJJJ-2 at 128), and could never articulate what he supposedly said to G&W but would only characterize it vaguely as "hints", "inkles" and "important" (see 611a, 622a, 656a). His testimony also included a monologue on the evils of exchange offers (600a-03a), claiming that G&W had inflicted "material damage" on Allis by buying its shares (691a-92a). However, the evidence showed instead that the financial failures of Allis long predated the Exchange Offer (636a-37a, 1435a), and were homegrown, as Stevenson's immediate successor, David C. Scott, frankly admitted (1498a-1503a).

shares (1503a). Stevenson took part in discussions to encourage G&W to sell to the Fiat interests in Italy (Dx-JJJJ-2 at 126-127). In late September, White Consolidated Industries, Inc. ("White") and G&W began discussions (347a, Bluhdorn dep. 87-90), and on October 31 they announced that White would acquire G&W's Allis shares (Dx-GGGG, ex. 4).

The agreement (the "White Agreement"), dated as of October 31, 1968 but not made final until later, contained numerous conditions to be satisfied at the closing (1163a-76a). On December 6, 1968, G&W sold its Allis shares to White in exchange for (a) 250,000 unregistered shares of White common stock; (b) an unsecured 8½% promissory note in the face amount of $93,680,000 payable in 6 months; and (c) only $20,000,000 in cash, since White had not been able to borrow more at that time (1163a-64a, 1222a, 1230a, 1506a). White announced its purchase as part of a plan to acquire Allis (1507a).

G. Subsequent Events (Related Primarily to the Cross-Petition)

Shortly after the closing and again in March 1969, G&W tried to sell the White note through a New York investment house, but was told that the note was "not financible" and would have to be factored at a 10% to 15% discount from its face value (484a-89a, 492a-93a, 497a). Twelve days after the closing, Allis moved for a preliminary injunction in a Delaware federal court to block White's acquisition on antitrust grounds (1519a). White's chief financial officer gave evidence that if its investment in Allis stock were inhibited, White would incur "serious adverse" financial consequences and face severe difficulty in discharging the note (1520a). Allis lost its motion on January 22, 1969, *Allis-Chalmers Manufacturing Co.* v. *White Consolidated Industries, Inc.*, 294 F. Supp. 1263 (D. Del. 1969), and the Third

Circuit denied its application for a temporary restraining order pending appeal on February 3, 414 F.2d 506, 509, n.5 (3 Cir. 1969).

Following Allis' apparent defeat, White secured a credit agreement on March 5 by which it obtained funds to discharge the note then held by G&W (1219a), and caused the note to be paid on March 20 with interest (1295a). But on May 5, the Third Circuit enjoined the annual meeting at which White hoped to gain control (1536a; 414 F.2d at 509 n.6). On July 18, 1969 it reversed the district court and enjoined White from voting any or acquiring additional Allis shares or seeking board representation, thereby halting White's takeover attempt (414 F.2d at 526). The banks which had given White loans to pay the note became "very concerned" and sought financing from other sources because of White's financial trouble (499a-500a). This could not be arranged until 2 years later (500a, 1253a).

While it was pursuing its claims against White in Delaware, Allis commenced this action against G&W in the Eastern District of Wisconsin on January 6, 1969.

The Proceedings Below

A. The District Court

This case was tried in March 1973 on both issues of liability and the amount of profits, if any, on which expert economic testimony was adduced. The district court found G&W had no access to inside information either before or after it acquired Allis shares (*47a*); that there had been "no showing of wrongdoing" (*72a*); and that G&W "did nothing wrong, as far as speculative abuses are concerned" (*74a*). Rather G&W had been the target of a program of isolation and hostility by Allis' management, the court finding, *inter alia*, that Allis had halved its dividend "in its

fighting" of G&W (*69a*). Nevertheless the court felt constrained to impose technical liability and awarded $1,135,838 of "profit realized." However, it reflected its distaste for Allis' position by refusing its request for an award of dividends and prejudgment interest, calling these "unconscionable" and "retributive" on the facts of the case (*id.*).

B. The Court of Appeals

Allis did not pursue its claims for dividends and interest on appeal but continued to press certain valuation doctrines designed arbitrarily to "maximize" the recovery under § 16(b), claiming its $1.1 million windfall should be increased to over $12 million. G&W principally appealed on the issue of liability. The Court of Appeals for the Seventh Circuit, in an opinion by Judge Swygert for a panel including Judge Pell and Mr. Justice Clark, unanimously held that G&W's initial exchange offer acquisition was outside the scope and purpose of § 16(b), and rehearing en banc was denied upon a poll of the full court (*6a n.5*). Expressing general agreement with the Ninth Circuit's decision in *Provident Securities Co.* v. *Foremost-McKesson, Inc.*, 506 F.2d 601 (9 Cir. 1974), the court held that the purchase by which an outsider with no prior relationship with the issuer acquires more than 10% of the issuer's shares does not trigger § 16(b)'s automatic liability.

The court of appeals found, as had the district court, that "there is no possibility under the facts of this case that Gulf & Western could have made 'unfair use of information . . . obtained . . . by reason of [its] relationship to [Allis-Chalmers]'" in making the Exchange Offer acquisition (*5a-6a*). Examining the statutory language "in its totality" as well as the legislative history, the court determined that "the statute was never intended to reach such a transaction." (*6a*)

Rather, the court found, "Congress had in mind a specific type of two-part transaction consisting either of a purchase and subsequent sale, or a sale and subsequent repurchase" (*15a*), which Congress had viewed as a "conceptual unit" (*16a*). Since "the section was aimed at preventing speculation based on abuse on inside information, the section must have contemplated a *pre-existing* beneficial interest" (*id.*). Where the investor lacked insider status prior to the opening purchase, the court reasoned, "the full purchase/sale transaction could hardly be characterized as 'speculative' from the standpoint of insider abuse" (*id.*). Thus, G&W's acquisition of Allis shares in the Exchange Offer was held outside the statute.

Because G&W's purchase from Oppenheimer occurred when G&W was already a 10% owner, the court found liability. It also held that the district court had overstated the purchase price G&W paid to Oppenheimer by valuing incorrectly G&W's guarantee of the future value of its warrants. This resulted in increasing Allis' recovery by $1,106,080.

With respect to the value of the unusual $93,680,000 White note, the court disallowed the discounted fair market value which had been found by the district court on the basis of the evidence. The Court did not contend that the district court's finding was "clearly erroneous", but held that fair market value was not the applicable test; rather, the face amount of the note was said to be controlling (whatever the actual value) if paid before trial. This aspect of the decision is the subject of G&W's cross-petition. This revaluation of the note would have exposed G&W to a $4 million addition to the judgment, if the Court had not found the 3,000,000 Exchange Offer shares outside the statute.

Certain other determinations concerning valuation are not relevant here. Moreover, because the court held that

G&W's purchase while an outsider was not within the statute, it was not required to consider certain other issues (which would remain for consideration on remand should this Court disagree with the decision of the court of appeals[6]).

Contrary to certain erroneous suggestions made in the petition (at 7) and in oral argument by counsel for Foremost-McKesson, Inc. in No. 74-742 (Transcript at 9, October 7, 1975), G&W has always contended that the initial acquisition by an outsider is not a chargeable "purchase" under § 16(b). Specific references to the statutory proviso are contained in two affirmative defenses raised in G&W's answer (46a-47a). Indeed, it will be recalled that G&W was granted leave by the Court to file a brief as amicus curiae in *Reliance Electric Co.* v. *Emerson Electric Co.*, 404 U.S. 418 (1972) in support of its position, urging that the question here not be indirectly reflected upon in the *Reliance* case, since it was not then before the Court at the instance of the parties.[7] The Court's opinion expressly noted, "that question is not before us." 404 U.S. at 421.

6. These issues include: (1) whether the acquisition by exchange offer is excludable under the "pragmatic" test, even if the court's assessment of the statutory proviso is erroneous; (2) whether the district court erroneously refused to recognize, for valuation purposes, the essentially undisputed impact of arbitrage on G&W warrants during the exchange offer, thus charging G&W with an artificially low purchase price for the Allis shares (see *57a n.6)*.

7. Motion of Gulf & Western Industries, Inc. for Leave to File the Accompanying Brief as Amicus Curiae in Support of the Position of the Respondent, No. 1332, October Term 1971, pp. 2-4.

The Decision Below on the Question Presented Should be Summarily Affirmed if Certiorari is Granted; Alternatively, the Writ May Properly be Denied.

Respondent does not oppose the grant of a writ of certiorari—although it believes the decision below to be correct—because the same legal issue on different facts is currently under review in the *Foremost-McKesson* case. Respondent was permitted to file a brief as amicus curiae in that case, which is appended hereto.[8] However, it has not had, and would welcome, the opportunity of plenary argument so that the "first-purchase issue" might be appraised in light of the compelling facts in its own case. Moreover, because the facts differ substantially from those in *Foremost-McKesson*, we submit that certiorari may be denied here whatever the result in that case.

The statutory purpose cannot be served by treating G&W's acquisition by Exchange Offer—announced well in advance, available to all shareholders on an open and equal basis, and preceded by complete financial disclosure—as if it were an insider's purchase on advance information. G&W was an "outsider" when it made the Exchange Offer (*46a*). Afterwards it was viewed and treated by Allis as an "undesirable suitor" and "unwanted mate". It sold its shares only after it had been systematically isolated by Allis' management and put remote from its enormous investment, and following further public disclosure of Allis' financial condition (1494a-1503a). There was no access to inside information. Given the undisputed sequence of events and disclosures, G&W could not use it even if it had any. The statutory purpose cannot be served by the imposition of a purposeless liability.

Petitioner's position would treat a defendant who owned *none* of the issuer's shares at the time of its purchase the

8. Citations to respondent's prior brief as amicus curiae are in the form "(1b)".

same as one who already owned over ten percent, thereby treating outsiders and insiders alike. Such an illogical reading would subvert the terms of the statute, its rationale and its purpose, as revealed by the legislative history. Specifically, the statutory proviso, applicable only to *non-managerial* "beneficial owners", expressly bars liability except where the specified "relationship to the issuer" existed "at the time of" the purchase. This gives an unmistakable basis for charging an otherwise innocent—and indeed, as here, a potentially beneficial—commercial event. Otherwise, the statute would act as a capricious barrier to important economic transactions.

Thus, when petitioner tries to deprecate the statutory exemption, saying it makes liability depend upon the "calculated or fortuitous reason that the beneficial owner purchased all such stock in one transaction," (Pet. at 9), this simply ignores the very basis upon which Congress made liability depend as an essential, elemental matter, *viz:* the specified "relationship to the issuer" at the time the purchase is undertaken.

This is not to say that there is no federal policy respecting the acquisition of a large block of shares by an outsider. Rather, that type of transaction raises concerns which are very different from those inherent in the problem of insider trading, and is addressed by other areas of the federal statutory system.[9] This Court has said, "If there are evils to be redressed by way of deterring those who would make tender offers, § 16(b) does not appear to us to have been designed for this task", *Kern County Land Co.* v. *Occidental Petroleum Corp.*, 411 U.S. 582, 597-98 (1973). The blurring of these quite different problems underlies petitioner's arguments.

9. Congress recently revised regulations covering this area in the Williams Act Amendments to the Securities Exchange Act of 1934, §§ 13(d)-(e); 14(d)-(f); 15 U.S.C. §§ 78m(d)-(e); 78n(d)-(f). Moreover, where, as here, the outsider offers its own securities in the acquisition, it must file a Registration Statement and Prospectus under the Securities Act of 1933, and must attempt to set forth detailed information about the financial condition of the issuer of the shares to be acquired, as well as its own. SEC Rule 409, 17 C.F.R. § 230.409; General Instruction F to SEC Form S-1, 2 CCH Fed. Sec. L. Rep. ¶8006 at 7016. See pp. 4-5, *supra*.

A related error inheres in petitioner's reliance (Pet. at 13) on the decision in *Reliance Electric Co.* v. *Emerson Electric Co., supra,* which, to the contrary, makes clear the inapplicability of the statute here. The heart of the problem in *Reliance* was that the "second sale" could analytically be viewed as within the statutory intent, because "tainted" by the same presumed access to information that infected the immediately preceding "first sale". The question therefore was whether the express statutory exclusion could be avoided so that the second sale might be reached, but the Court rejected the proposed circumvention. Here, there is not even an analytical argument that the initial purchase is theoretically tainted by access to inside information. Thus, given the statutory exemptive language, liability would *a fortiori* be wrong. Indeed, the whole thrust of the *Reliance* decision was to reinforce the exemptive proviso, holding that it is one of the "objective standards" of § 16(b) which "cannot be disregarded", 404 U.S. at 423, 424.

There has never been a satisfactory basis for charging an outsider's initial ten-percent transaction, and there has been no consistent line of authority to support it. For almost 15 years, there were only two decisions on the issue, each contrary to the other: one, *Stella* v. *Graham-Paige Motors Corp.*, 104 F. Supp. 957 (S.D.N.Y. 1952), decided on a preliminary motion and later affirmed without analysis by a divided court, 232 F.2d 299 (2 Cir.), *cert. denied*, 352 U.S. 831 (1956); the other, *Arkansas-Louisiana Gas Co.* v. *W. R. Stephens Investment Co.*, 141 F. Supp. 841 (W.D. Ark. 1956), which was not appealed.

The decision in the *Stella* case (in which there was no liability because there were no profits), was based upon the theory of *recurrent* insider status where, hypothetically, an investor could buy stock, sell down to under ten percent, and then repeat the process "ad infinitum", 104 F. Supp. at

959. There are several difficulties with the theory, not the least of which is that it has not the slightest application where the defendant, as here, had no prior relationship at the time of the very transaction in question. Another is that hypothetical "taint" is not a basis for ignoring the exemption. *Reliance Electric Co.* v. *Emerson Electric Co., supra.* Yet a more basic one is that a stockholder trading in and out of a ten percent position does not even fit the mold of the "insider" which Congress envisioned as the likely possessor of inside information. Indeed, this Court suggested in *Reliance* that

> "it may be that Congress regarded one with a long-term investment of more than 10% as more likely to have access to inside information than one who moves in and out of the 10% category." 404 U.S. at 424.

The next time it spoke on the issue, in *Newmark* v. *RKO General, Inc.,* 425 F.2d 348 (2 Cir.), *cert. denied,* 400 U.S. 854 (1970), the Second Circuit did not adopt the rationale of the *Stella* case. Rather, in dictum not remotely related to the facts of its case, the court first conceded that the initial purchase *cannot* be presumed to be based on inside information, but added that *subsequently* acquired information would enable the alleged insider "to sell his shares at the moment most advantageous to him." 425 F.2d at 356. These comments were pure dictum, since the court found that the defendant both was in fact a statutory "beneficial owner" *before,* and actually used inside information at the time of, the purchase. *Id.* But beyond this, the suggestion in the *Newmark* dictum has uniformly been criticized as irrelevant to the problem and providing the basis for only a Rule 10b-5 action—if indeed there was actual use of inside information. See *e.g., Gold* v. *Sloan,* 486 F.2d 340, 349 (4 Cir. 1973), *cert. denied,* 419 U.S. 873 (1974); Comment, *Section 16(b): An Alternative Approach to the Six-Month Limitation Period,* 20 U.C.L.A. L. Rev., 1289, 1297 (1973); Note, *Stock Exchanges Pursuant to Corporate Consolidation: A Section 16(b) "Purchase or Sale"?,* 117 U. Pa. L. Rev. 1034, 1041-42 n. 39 (1969).

Not surprisingly, the Second Circuit in *Perine* v. *William Norton & Co.,* 509 F.2d 114 (2 Cir. 1974), while paying respect to its own prior decisions, nevertheless substantially undercut their support by holding that, if any underwriter who made a ten-percent purchase was not a "pre-existing insider", it was not required to satisfy all conditions of SEC Rule 16b-2 in order to exempt the transaction. It thus gave determinative weight to the absence of a prior inside relationship in a § 16(b) case involving a mere shareholder. 509 F.2d at 120-121.

Petitioner wholly ignores that Congress made assumptions with respect to managerial insiders (officers and directors) very different from those respecting nonmanagerial shareholders, and that this distinction underlies the statutory proviso at issue. *Adler* v. *Klawans,* 267 F.2d 840 (2 Cir. 1959). Officers and directors have not merely a probability of access to, but indeed a duty to become apprised of, internal corporate information. In contrast, large shareholders need never have such access; and the circumstances surrounding the acquisition of shares are not predictable. Clearly, large shareholdings may be acquired without any confidential involvement. The instant case, involving unquestioned compliance with federal advance disclosure requisites, is exemplary.

According to its draftsmen, § 16(b) was:

> "aimed at protecting the public 'by preventing directors, officers, and principal stockholders of a corporation . . . from speculating in stock on the basis of information not available to others' S. Rep. No. 792, 73d Cong., 2d Sess., 9 (1934)" *Kern County Land Co.* v. *Occidental Petroleum Corp., supra,* 411 U.S. at 592.

Disclosure, especially by an outsider, goes to the heart of the problem at which § 16(b) was aimed, as the Fourth Circuit noted recently:

> "[I]t is the unfair use of inside information against which the statute is directed and plainly where there has been full disclosure . . . the potential for unfairness and any basis for invoking the statute disappears." *Gold* v. *Sloan, supra,* 486 F.2d at 349.

An Exchange Offer, characterized by safeguards against unfairness, is wholly unsuited for § 16(b)'s brand of abuse. The open offer to all shareholders, ratable treatment, the premium above market value, the possibility of substantial future benefits for both corporations involved, and especially the full prior disclosure of all material financial information—all set an Exchange Offer starkly apart from the covert market trading which Congress had in mind in enacting § 16(b).

Indeed, one much-cited article contrasts an exchange offer and its counterpart, the cash tender offer (the "purchases" in the *Kern County* case), from the viewpoint of trading fairness. While on one hand a cash tender offer is merely a "form of a market purchase", on the other "an exchange offer closely resembles a merger transaction", inextricably bound up with the provision of "sufficient information" as to the target corporation and surrounded by numerous safeguards.[10] "Exchange Offers are unusual."[11] One made by an outsider can hardly be viewed

10. A. Fleischer & R. Mundheim, *Corporate Acquisition by Tender Offer,* 115 U. Pa. L. Rev. 317, 348-349 (1967).

11. "Exchange Offers are unusual. First, . . . they must be registered under the Securities Act of 1933 and will have to comply with state Blue Sky laws. . . . Second, to make the requisite disclosures about the sought-after company may require the cooperation of management. . . . Third, exchange offers lack the element of surprise. . . . Finally, in an exchange offer involving registration under the

as one of the "class of transactions in which the possibility of abuse was believed to be intolerably great," *Reliance Electric Co.* v. *Emerson Electric Co., supra,* 404 U.S. at 422, and to which the statute is limited. *Id.*

The issue in *Kern County* was whether the "closing" transaction was a sale. Where the question is whether the opening acquisition is chargeable as a § 16(b) "purchase", the inquiry asks whether the acquisition was "an anticipatory action based upon inside information" looking toward a subsequent profit-taking sale. Comment, *supra,* 20 U.C.L.A. L. Rev. at 1295. In *Gold* v. *Sloan, supra,* the Fourth Circuit held that inquiry into an opening transaction must focus upon the critical period *preceding* the alleged "purchase", and that

> "if there is in the transaction itself, and the negotiations leading up to it, an absence of abuse, then the deterrent force of the statute is unnecessary and liability is not in order." 486 F.2d at 343.

In appraising whether an opening transaction would be charged, it held that the relevant facts were those leading up to the transaction, since

> "circumstances or events occurring after the transaction in question cannot possibly be relevant in determining whether there was a possibility of speculative

Securities Act, [the offeror] is severely restricted under § 5 of the act, 48 Stat. 77 (1933), as amended, 15 U.S.C. § 77e (1964), with respect to statements made. . . .

"[U]nless stock has already been authorized, the offeror must secure a vote of its shareholders for an appropriate amendment to its charter. . . . [I]ssuance of the shares in connection with the exchange offer may need shareholder approval under certain state laws. . . . or, under the rules of the major exchanges. . . . See, e.g., New York Stock Exchange, Company Manual A-284(3). Finally, if the shares to be issued by the offeror constitute a substantial part of its outstanding stock, it may be contended that the transaction constitutes a de facto merger. . . ." *Id.* 348 n. 119.

abuse when such transaction occurred," 486 F.2d at 349.[12]

When G&W decided to make its Exchange Offer, it had no association with Allis and was not even a shareholder; thus its decision "could not have been based on inside information obtained from substantial stockholdings that did not yet exist." *Kern County Land Co.* v. *Occidental Petroleum Corp., supra,* 411 U.S. at 597. To comply with disclosure rules, it announced its decision immediately (1400a-01a), stating the exact consideration it would offer (*id.*). This amount, determined while G&W was an outsider (*46a*), never varied (1031a). The announcement gave the market ample time to anticipate the offer and adjust for it. *See* Note, *Insider Liability for Short-Swing Profits: The Substance and Function of the Pragmatic Approach,* 72 MICH. L. REV. 592, 612 (1974). In the next two months G&W made intensive disclosure efforts, even paying Allis' costs to ensure the quality and completeness of disclosure. Both G&W and Allis were subject to severe civil and criminal sanctions for any material deficiency in the disclosure,[13] and there was no deficiency (546a-47a). Allis, its lawyers and accountants gave G&W written assurance that the disclosure was com-

12. "[F]ocusing on the possibility of inside information after the initial transaction is an irrelevant criterion" when the issue is whether an initial acquisition is an abusive "purchase". Comment, 20 U.C.L.A. L. REV., *supra,* at 1297. *See also Perine* v. *William Norton & Co., supra.*

13. 15 U.S.C. §§ 77k, *l*, q, x; SEC Rule 409, 17 C.F.R. § 230.409; General Instruction F for Form S-1, 2 CCH FED. SEC. L. REP. ¶ 8006 at 7016. G&W would be strictly liable for any faults in disclosure. 15 U.S.C. § 77k. Moreover, the intentional provision of false information would give rise to criminal liability under the 1933 Act for aiding and abetting. Rule 10b-5, issued under § 10 of the 1934 Act, 15 U.S.C. § 78j, also bore directly on G&W and Allis' disclosure obligations. *See, e.g., S.E.C.* v. *Texas Gulf Sulphur Co.,* 401 F.2d 833, 839, 891 (2 Cir. 1968), *cert. denied,* 394 U.S. 976 (1969); *Heit* v. *Weitzen,* 402 F.2d 909 (2 Cir. 1968), *cert. denied,* 395 U.S. 903 (1969); *Escott* v. *BarChris Const. Co.,* 283 F. Supp. 643 (S.D.N.Y. 1968).

plete (1422a-32a). Indeed the Prospectus even provided the latest earnings projections and assessments of price and cost trends (1132a) at the insistence of counsel (1415a). G&W could acquire no shares under the Exchange Offer until after the information was distributed to the investing public. In addition, in voting upon the Exchange Offer, G&W's shareholders had exactly the same information as did Allis' shareholders; the proxy statement and the Prospectus were substantially identical. This was simply unsuited to unfair informational abuse. Disclosure about Allis continued throughout the offering period (1433a-41a). Although the news indicated further deteriorating earnings —continuing the trend since 1967—G&W nevertheless went forward with the acquisition at a premium price.

Such a transaction could not possibly have been in anticipation of a short-swing profit based on inside information. Full disclosure at the critical time (or the pointed absence of it), has been given repeated emphasis in § 16(b) cases,[14] since "if any relevant information that an insider may have prior to beginning his short swing is shared by the investing public, there is no 'possibility' of abuse." Note, *supra,* 72 MICH. L. REV. at 611 (1974). Similarly, the idea that Allis should gain a windfall recovery because it succeeded in its policy of isolating G&W, which had offered Allis shareholders both a premium price and the prospect that Allis' decline might be reversed through professional aid, must be "repugnant to our sense of

14. *See Kern County Land Co.* v. *Occidental Petroleum Corp., supra,* 411 U.S. at 600; *Roberts* v. *Eaton,* 212 F.2d 82, 83 (2 Cir.), *cert. denied,* 348 U.S. 827 (1954) (proxy statement provided a "full discussion of the proposal"); *Ferraiolo* v. *Newman,* 259 F.2d 342, 346 (6 Cir. 1958), *cert. denied,* 359 U.S. 927 (1959) ("full disclosure was made"); *Petteys* v. *Butler,* 367 F.2d 528, 537 (8 Cir. 1966), *cert. denied,* 385 U.S. 1006 (1967) ("the stockholders were adequately informed"). *Compare: Newmark* v. *RKO General, Inc., supra,* 425 F.2d at 356.

equity." See *Abrams* v. *Occidental Petroleum Corp.*, 450 F.2d 157, 164 (2 Cir. 1971), *aff'd sub nom. Kern County Land Co.* v. *Occidental Petroleum Corp., supra.*

Although subsequent events do not directly bear on whether an opening acquisition was based on inside speculation, they are nevertheless instructive in showing how Allis contrived to dispose of its "unwanted mate". Allis' management could not appeal to the Allis shareholders to refuse G&W's offer or otherwise openly oppose because Allis' shareholders were "unhappy" with management, "antagonistic", and upset in particular by its apparent undoing of previous offers (639a-640a). Nor could management arrange a "defensive merger", as in *Kern County,* since it had alienated the likely candidates (DX-JJJJ-1 at 16, 18-22). Instead, it adopted a covert policy to discourage G&W and put it remote from its investment. G&W was even worse off than "simply a disaffected stockholder . . . tolerated but not welcomed by the management", *Gold* v. *Sloan, supra,* 486 F.2d at 344, because G&W was not tolerated.

Allis slashed its dividend right after G&W made its acquisition, advising G&W only simultaneously with public announcement and making it clear that there would be no advance consultation (615a). When Bluhdorn suggested in passing that Judelson might be invited onto the Allis board, Stevenson recorded it in his notes as a "threat" (1326a); the next time he hid behind the FTC inquiry (625a). When G&W sent an expert manufacturing trouble-shooter to Allis' headquarters to give aid, he was run through one facility and sent back to New York (321a, 613a). While Allis searched for a new president, it kept G&W totally in the dark, so that even a Milwaukee newspaperman knew more about Allis than G&W did, and Allis would say nothing when G&W inquired (618a). And although Stevenson claimed at trial that he gave G&W weighty and important "hints" and "inkles" about Allis' performance at his September 13 visit, all the hard evidence suggested other-

wise. His notes disclose no discussion of Allis' performance (1330a), and even Stevenson conceded that when he subsequently told G&W, simultaneously with public announcement on October 21 (330-31a; 667a), of Allis' real financial results, G&W's officers, far from reflecting forewarning, were "floored" (667a). G&W sold no shares until well after Allis' public disclosures. The trial court rejected Stevenson's professed motives, and saw his September 13 visit to G&W as part of the continuing effort to give G&W a sour and distant view of its enormous investment in Allis (*48a*). Even Stevenson's own version was robbed of any relevance by the financial disclosures of October 21.

Because G&W has previously devoted attention to unfolding of the legislative history preceding the enactment of Section 16(b) (10b-17b), it would not be useful to dwell on it here, except to take note of the attack made by petitioner on the analysis of both the Seventh Circuit and the Ninth Circuit (Pet. at 12-13). The entirety of that attack is based, as we best understand it, on the claim that it was somehow error for these courts to go back to "a Senate bill" (*id.* 12)—which, petitioner fails to point out, was the "Fletcher-Rayburn" bill introduced in *both* the House and Senate[15]—in order to assess the intent of the legislation. In fact, the Fletcher-Rayburn bill alone was the subject of the legislative hearings which are uniformly relied upon as establishing the purpose and operation of this statute. (See note 15, *infra*) Indeed, when petitioner claims that a

15. S. 2693, introduced by Sen. Fletcher and referred to the Senate Banking and Currency Committee, February 9, 1934, considered in *Hearings on S. Res. 84 & S. Res. 97 Before the Senate Committee on Banking and Currency,* 73d Cong., 2d Sess. (1934); H.R. 7852, introduced by Rep. Rayburn and referred to the House Committee on Interstate and Foreign Commerce, February 10, 1934, considered in *Hearings on H. R. 7852 Before the House Committee on Interstate and Foreign Commerce,* 73d Cong., 2d Sess. (1934).

subsequent unspecified "House bill" must be regarded as the "lineal predecessor" of Section 16(b) (Pet. at 12) this turns out to be an entirely arbitrary choice of pedigree, and simply wrong. The only bill voted upon by the House prior to the conference committee's final version was H.R. 9323, which omitted entirely the provision now known as Section 16(b). See 12b-13b.

Finally, petitioner's repeated invocations of the statutory "purpose" as a basis for liability deserve no consideration, for they beg the question and ignore the fact that the purpose of the statute is a limited one. Section 16(b) is served by giving it application "without extending the reach of the statute beyond its intended limits." *Kern County Land Co.* v. *Occidental Petroleum Corp., supra,* 411 U.S. at 595. A purchase by an outsider who never becomes an officer or director is not logically, nor within the statutory language, one of the "class of transactions in which the possibility of abuse is intolerably great," *Reliance Electric Co.* v. *Emerson Electric Co., supra,* 404 U.S. at 422, and is therefore not within the automatic liability imposed by the statute.

Conclusion

For the reasons stated, the writ of certiorari may be granted and the decision below summarily affirmed on the question presented, or, in the alternative, the writ of certiorari should be denied, since the decision below was clearly correct.

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APPENDIX

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Illinois, *Allis-Chalmers Manufacturing Co.* v. *Gulf & Western Industries, Inc.,* 372 F. Supp. 570 (N.D. Ill. 1974). A principal issue there is whether an outsider's initial acquisition of a greater than 10% interest must, on any facts, be a chargeable transaction, in the face of the statutory exemption which states that the statute "shall not be construed" to impose liability where "such beneficial owner was not such both at the time of the purchase and sale".

G&W concededly had no prior relationship to the issuer. It acquired 3,000,000 shares in a single transaction pursuant to a public exchange offer, preceded by a full, indeed extraordinary, disclosure effort (regarding *both* G&W and Allis) in conformity with the Securities Act of 1933, 15 U.S.C. §§ 77a-aa, and other laws. The trial court has found that G&W "did nothing wrong as far as speculative abuses are concerned" (372 F. Supp. at 591), that there had been "no showing of wrongdoing" (*id.,* 590) and that G&W did not have confidential corporate information "either before or after its purchase" (*id.,* 579). Immediately after the acquisition, G&W became the target of a program of isolation and hostility by Allis' management, the cou ' finding, *inter alia,* that Allis had used a dividend cut "in its fighting" of G&W (*id.,* 589). Nevertheless, the court felt bound to impose technical liability and awarded $1,135,838 of "profit realized".[1] However, it reflected its distaste for Allis' position by refusing its requests for an award of dividends and prejudgment interest, calling them "unconscionable" and "retributive" in the circumstances (*id.,* 589). It is a clear case where liability cannot possibly serve the statutory purpose.

1. A subsequent smaller acquisition is also at issue there.

On its appeal Allis has dropped these claims for dividends and interest but insists that the windfall recovery of $1.1 million was too meager, urging that arbitrary profit-"maximization" rules compel an award of over $12 million. G&W cross-appealed, principally on the critical issue of liability. Because the number of shares involved in G&W's first and concededly innocent acquisition is very large, G&W's stake in the issue before this Court is very substantial.[2]

Questions That May Not Be Adequately Presented by the Parties

Section 16(b) clearly requires that a shareholder-defendant be an insider "at the time" of the purchase, not afterwards—thus conforming to the idea that the decision to purchase be based on the statutorily specified "relationship to the issuer" and the information presumably gained thereby. However, some have claimed to find an "ambiguity" in the statutory language which is said to give license to enlarge liability based on expansive "policy" arguments. Under governing precedent, the issue here must be resolved (1) strictly within the statutory terms, *Reliance Electric Co.* v. *Emerson Electric Co.,* 404 U.S. 418 (1972), or (2) if there is ambiguity, on the specific facts of each case to determine if liability would serve the limited aims of the statute, *Kern County Land Co.* v. *Occidental Petroleum Corp.,* 411 U.S. 582, 595 (1973).

In either case, it seems critical that the decision here have the perspective of other real-world situations involving the same issue. The facts of the instant case are highly particularized, and the parties have little reason to focus

2. G&W was previously granted leave to present its views as *amicus curiae* concerning the exemptive proviso in *Reliance Electric Co.* v. *Emerson Electric Co.,* 404 U.S. 418 (1972).

upon possible results in other circumstances, such as in the *Allis-Chalmers* case under review in the Seventh Circuit. That case indicates, possibly better than any other, the error in fabricating liability without proof of wrongdoing where there has been no prior statutory "relationship to the issuer" and there is no possibility of the "types of speculative abuse that the statute was designed to prevent." 411 U.S. at 594 n. 26.

In that case, not only was there no pre-acquisition "inside" relationship, but instead of capitalizing on inside information, G&W undertook to guarantee prior disclosure. Its acquisition was by registered exchange offer pursuant to prospectus,[3] made at a premium above market, announced well in advance, and offered on a pro rata basis. G&W persuaded Allis to collaborate, if not cooperate, in the disclosure process,[4] paid the expenses of its accountants, lawyers, and management in doing so, and demanded and received from each a certification of disclosure accuracy. The result was a highly detailed description of the business condition of both companies—which, particularly in the case of the issuer (Allis), exceeded traditional standards by estimating future earnings and projecting cost and price trends.

Once G&W had finalized its acquisition, it was isolated by Allis. Internal matters were consistently kept from G&W on the basis that it was outside "management". With

3. The "unusual" protective and nonspeculative conditions surrounding exchange offers are described in detail in Fleischer & Mundheim, *Corporate Acquisition by Tender Offer*, 115 U. PA. L. REV. 317, 348 n. 119 (1967).

4. See Instruction F to Form S-1, CCH Fed. Sec. L. Rep. ¶7122, at 6202 (1971) (requiring the exchange offer prospectus to set forth business and financial information with respect to the respective issuers of *both* the securities sought and those being offered); and SEC Rule 409 issued under the Securities Act of 1933, 17 CFR §230.409 (requiring the offeror to seek disclosure from the target corporation).

a $115 million investment adrift, G&W, encouraged by Allis, sold its shares to another large industrial corporation which sought them for the purposes of merger. Again, no sale took place until well after public disclosure by Allis of important current financial results.

A "first purchase" by an outsider in an exchange offer based upon full prior disclosure simply does not fit the mold of the statutory target:

> "After all, it is the unfair use of inside information against which the statute is directed and plainly when there has been full disclosure, as is given by a proxy statement, the potential for unfairness and any basis for invoking the statute disappears." *Gold* v. *Sloan,* 486 F.2d 340, 349 (4 Cir. 1973), *cert. denied,* 419 U.S. 873 (1974).[5]

It is with the aim of bringing consideration more directly to bear on such a situation and to contribute the views developed in our litigation that we respectfully request the privilege of submitting the accompanying brief as *amicus curiae.*[6]

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5. Prior disclosure, or the lack of it, has repeatedly been emphasized in § 16(b) cases in determining whether there should be liability. *Kern County Land Co.* v. *Occidental Petroleum Corp., supra,* 411 U.S. at 600; *American Standard, Inc.* v. *Crane Co.,* 510 F.2d 1043, 1054 (2 Cir. 1974); *Roberts* v. *Eaton,* 212 F.2d 82, 83 (2 Cir.), *cert. denied,* 348 U.S. 827 (1954); *Ferraiolo* v. *Newman,* 259 F.2d 342, 346 (6 Cir. 1958), *cert. denied,* 359 U.S. 927 (1959); *Petteys* v. *Butler,* 367 F.2d 528, 537 (8 Cir. 1966), *cert. denied,* 385 U.S. 1006 (1967). *Compare: Newmark* v. *RKO General, Inc.,* 425 F.2d 348, 356 (2 Cir.), *cert. denied,* 400 U.S. 854 (1970).

6. Allis has similarly moved to file a brief as *amicus curiae* ("Allis Br.").

BRIEF IN SUPPORT OF THE POSITION OF THE RESPONDENT

Question Presented

Whether the purchase by which an outsider with no prior relationship with the issuer acquires more than ten percent of any class of the issuer's securities must be included as a transaction within § 16(b), despite the statutory exemptive proviso stating that § 16(b) "shall not be construed" to cover such a transaction.

Summary of Argument

Section 16(b) is a special recovery tool, designed to take away profits made by corporate "insiders" in linked "purchases" and "sales" of stock within six months, based upon advance inside information. Because the statute can create liability in the absence of wrongdoing and because of the availability of other remedies in the event of actual abuse, this Court has held that § 16(b) should not be expanded beyond its intended limits. Yet in the situation before the Court liability cannot possibly serve the statutory purpose. Rather, the petitioner would ignore the express statutory exemptions and seeks an automatic rule which would extract recovery from those who are statutory outsiders at the time they buy, and cannot be presumed to have inside information, but rather often provide affirmative disclosure.

The legislative history shows that Congress aimed at a set of transactions by those with a confidential "relationship to the issuer," enabling them to buy, intending or expecting to make a profit on a shortswing sale. Whatever other assumptions may have been made with respect to managerial insiders (officers and directors), Congress clearly distinguished the situation of those who held shares but were not part of management, since neither the process of obtaining ten-percent ownership nor the position held upon attaining such status necessitates confidential involvement with the issuer. The express proviso bars shareholder liability except when the requisite status existed at the time of the purchase, so that there would be an unmistakable basis for charging an otherwise innocent commercial transaction.

Attempts to force liability in these circumstances are in direct conflict with the logic of the statute and plainly incompatible with the major elements of its operation, including the six-month holding provision, the statutory measure of recovery, and underlying presumption which sustains the statute.

There are no valid "policy" arguments which can support artificially labeling an outsider's investment as an abusive transaction by an insider. To the contrary, decisions of this Court have required that the "proofless" liability of Section 16(b) be confined to situations where liability will serve the statutory purpose and respect its intended limits, and such decisions cannot be squared with the enlargement of liability sought by the petitioner here.

Argument

A. The statute and its purpose

Section 16(b) was designed to attack short-swing trading by officers, directors and certain large shareholders "in the stock of their own companies with the benefits of advance information." S. Rep. No. 792, 73d Cong., 2d Sess. 9 (1934). The Congressional target was the situation in which the "insider" purchased on favorable inside information and sold when the price rose (or sold on unfavorable information and then repurchased). "Inside information" is that acquired "by reason of his relationship to the issuer", 15

U.S.C. § 78p(b). While its general purpose is to "preclude the 'unfair use of information . . . by' corporate insiders," it is clear that,

> "Congress did not seek to accomplish the whole of this purpose by section 16(b) alone . . . [which] creates a special remedy, applicable only in a limited situation. . . . [O]ther remedies are . . . available, but only upon proof of actual wrong-doing." *Blau* v. *Max Factor & Co.*, 342 F.2d 304, 307 (9 Cir.), *cert. denied,* 382 U.S. 892 (1965) (footnote omitted).

Because § 16(b) creates an "extraordinary liability" which may attach without proof of wrongdoing, the Court has consistently held that neither the statute nor rules in aid of its implementation may be expanded beyond its limited scope in the guise of effecting some remedial purpose,[7] *Blau* v. *Lehman,* 368 U.S. 403, 411-13 (1962). In *Blau* v. *Lehman, supra,* the Court rejected a supposed "prophylactic" rule which would subject partnership profits to § 16(b) by treating a partnership as a statutory "insider" if a partner was one. In *Reliance Electric Co.* v. *Emerson Electric Co., supra,* the Court turned aside a reading of the statute which would have weakened the very exemption at issue here—despite supposed "policy" arguments to the contrary. 404 U.S. at 424.

In the landmark case *Kern County Land Co.* v. *Occidental Petroleum Co., supra,* the Court emphasized that the public interest lies in the implementation of § 16(b) *"without extending the reach of the statute beyond its intended limits."* 411 U.S. at 595 (emphasis added). The Court stressed that the statute's potential for imposing liability without wrongdoing has necessitated a measured approach: "Under these strict terms, the prevailing view is to apply the statute only when its application would serve its goals." *Id.* The Court gave final authority to the modern "pragmatic" view that there is no public interest in the imposition of "purposeless harshness." See *Blau* v. *Max Factor & Co., supra,* 342 F.2d at 307.

7. This view of § 16(b) contrasts with that taken of § 10, the Act's broadly-based antifraud provision which affords a federal remedy against those who are proved to have done actual harm. Indeed, the efficacy and breadth of § 10 eliminates the need for expansionary application of § 16(b); *see, e.g.,* Note, *Reliance Electric and 16(b) Litigation: A Return to the Objective Approach?*, 58 VA. L. REV. 907, 914-15, 928-29 (1972); Lowenfels, *Section 16(b): A New Trend in Regulating Insider Trading,* 54 CORNELL L.Q. 45, 61-64 (1968), both cited by the Court in the *Kern County* case, 411 U.S. at 594 n. 26.

B. The legislative history shows clearly that Congress intended as the target of § 16(b) the investor with inside information as the basis of its opening transaction.

Virtually all recent critical commentators strongly reject the idea that the initial more-than-10% transaction by an outsider should be subject to § 16(b) as both indefensible logically and inconsistent with the legislative purpose. Note, *Securities—Section 16(b)—Initial Purchase of Ten Percent of a Class of Equity Securities Is Not a Section 16(b) Purchase,* 43 FORDHAM L. REV. 678 (1975); Note, *Insider Liability for Short-Swing Profits: The Substance and Function of the Pragmatic Approach,* 72 MICH. L. REV. 592, 597 n. 26, 602-19 (1974); Comment, *Section 16(b): An Alternative Approach to the Six-Month Limitation Period,* 20 U.C.L.A. L. REV. 1289, 1294-1300, 1312-13 n. 125 (1973); Note, *Reliance Electric and § 16(b) Litigation: A Return to the Objective Approach?,* 58 VA. L. REV. 907, 910-11 (1972); Comment, *Exchange of Stock Pursuant to a "Defensive Merger" is Not a "Sale" Within the Meaning of Section 16(b),* 72 COLUM. L. REV. 1090, 1101-02 (1972); Comment, *Exchange of Stock Pursuant to Merger is "Sale" by Insider under Section 16(b) of Securities Exchange Act of 1934,* 84 HARV. L. REV. 1012, 1022 n. 30

(1971); Note, *Stock Exchanges Pursuant to Corporate Consolidation: A Section 16(b) "Purchase or Sale"?*, 117 U. PA. L. REV. 1034, 1042 n. 39 (1969); Munter, *Section 16(b) of the Securities Exchange Act of 1934: An Alternative to "Burning Down the Barn to Kill the Rats"*, 52 CORNELL L. Q. 69, 75 (1966); Comment, 70 HARV. L. REV. 1312 (1957); Comment, 9 STAN. L. REV. 582 (1957); W. PAINTER, FEDERAL REGULATION OF INSIDER TRADING 41-42 (1968).

The specific "evil which Congress sought to prevent", *Kern County Land Co.* v. *Occidental Petroleum Corp., supra,* 411 U.S. at 594, by means of § 16(b) is clear from the history of the act. The original "Fletcher-Rayburn" bill[8] rendered unlawful[9] any purchase by specified persons made "with the intention or expectation" of selling the same security within six months:

> "It shall be unlawful for any director, officer, or owner of securities, owning as of record and/or beneficially more than five per centum . . .
>
> (1) To *purchase* any such registered security *with the intention or expectation of selling* the same security within six months . . ." (emphasis supplied)

To establish civil liability, actual proof of such intention "in entering into such transaction" was specifically excluded:

> ". . . and any profit made by such person on any transaction in such a registered security extending over a period of less than six months shall inure to and be recoverable by the issuer, *irrespective of any intention or expectation on his part in entering into such transaction* of holding the security purchased for a period exceeding six months." (emphasis supplied)

8. S. 2693, introduced by Sen. Fletcher and referred to the Senate Banking and Currency Committee, February 9, 1934, considered in *Hearings on S. Res. 84 & S. Res. 97 Before the Senate Committee on Banking and Currency,* 73d Cong., 2d Sess. (1934), hereinafter *Senate Hearings;* H.R. 7852, introduced by Rep. Rayburn and referred to the House Committee on Interstate and Foreign Commerce, February 10, 1934, considered in *Hearings on H. R. 7852 Before the House Committee on Interstate and Foreign Commerce,* 73d Cong., 2d Sess. (1934), hereinafter *House Hearings.*

9. Section 24 of S. 2693 imposed criminal penalties for willful violation of any provision of the act.

The bill's chief spokesman explained at the Senate hearings (specifically focusing on the case of a director) that the statute used a presumption to obviate proof of the insider's intention *"at the time he bought":*

> "That [bill] is to prevent directors receiving the benefits of short-term speculative swings on the securities of their own companies, because of inside information. . . . You hold the director, irrespective of any intention or expectation to sell the security within 6 months after, because it will be absolutely impossible to prove the existence of such intention or expectation, and you have to have this crude rule of thumb, because you cannot undertake the burden of having to prove that the director intended, at the time he bought, to get out on the short swing."[10]

The statute aims expressly at the person who buys stock with "intention or expectation" based on inside information to sell at a short-term profit and necessarily contemplates the statutory relationship, and informational access, before his purchase. Moreover, as shown in the margin, legislative discussions of the "converse" situation, where an insider sells stock "with the intention of repurchasing"[11],

10. *Senate Hearings* 6557 (emphasis supplied). The passage is quoted in *Kern County Land Co.* v. *Occidental Petroleum Corp., supra,* 411 U.S. at 593 n.23.

11. "SENATOR BULKLEY. Do you provide for the converse of that, where a man might sell for a short term with the intention of repurchasing?

MR. CORCORAN. No; it should have been provided for. . . .

* * *

SENATOR BULKLEY. Yes. A man having a large amount of stock might know that his company was going to pass a dividend, and then sell it with the intention of purchasing after the news was out." *Senate Hearings* 6557-58 (Feb. 28, 1934).

make evident that Congress was concerned with persons with inside knowledge before the opening transaction.

The House hearings addressed this same problem. Indeed, the bill had a provision making "tippees" of insiders liable, which set forth the *critical sequence* of acquisition of information, followed by a short-term transaction "within a period not exceeding six months after such disclosure", H.R. 7852. Mr. Corcoran stated that "tippee" liability was designed to attack the very same type of transaction foreclosed to an insider, when carried on by his "friends."[12]

> "Mr. Corcoran: Now, on page 29, subsection (3), an insider tips off somebody with his inside information . . . and the person tipped makes a short swing profit on the stock." *House Hearings* 135.

Congressmen questioned the enforceability of the tippee provision (*Id.* 135-38) and ultimately deleted it.

After three weeks of hearings on H.R. 7852, the House Committee on March 20 presented a redraft, H.R. 8720.[13] Criminal liability and tippee liability were now deleted, and the converse "sale and purchase" transactions were included. Moreover, the new version added the exemptive proviso for "shareholder-insiders", requiring that they be "insiders" both at the time of the purchase and sale, also permitted administrative exemptions, and directly tied both exemptions to language declaring the purpose of the bill:

> "This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale or sale and purchase of the security involved, nor any transaction or transactions which the Commission by

12. In the Senate hearings the purpose of tippee liability was similarly described. *Senate Hearings* 6558 (February 28, 1934).

13. H.R. 8720, introduced by Rep. Rayburn and referred to the House Committee on Interstate and Foreign Commerce on March 19, 1934.

> rules and regulations may exempt as not comprehended within the purpose of this subsection of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer."

After further hearings, however, the House Committee deleted entirely the provision now known as § 16(b) and, on April 27, 1934 reported out a bill requiring insiders only to report their transactions (now § 16(a)) and refrain from short selling and selling "against the box" (now § 16(c)).[14] This was passed by the House on May 7, 1934.[15]

The Senate committee's revision, reported out on April 20, 1934, raised "insider" share ownership from 5% to 10% and adopted the exemptive proviso requiring shareholder-insiders to be such "both at the time of the purchase and sale", in apparent response to objections to treating large investors the same as officers or directors.[16] It also authorized administrative exemptions and placed the explicit statement of statutory purpose separately in the forepart of the statute.[17]

14. H.R. 9323, introduced by Rep. Rayburn and referred to the House Committee on Interstate and Foreign Commerce on April 25, 1934; reported out April 27, 1934.

15. The only House revision was a subsection excluding securities registered without the issuer's consent, H.R. 9323 as passed by the House, May 7, 1934.

16. "Senator Kean. I think it is all right to apply it to a director or officer, but I think to require the ordinary investor—

* * * * *

. . . you are interfering with the individual a good deal there. I agree with you with respect to the officers and directors.

Mr. Corcoran. A stockholder owning 5 percent is as much an insider as an officer or director. Whether he is a titular director or not, he normally is, as a practical matter of fact, a director.

Senator Kean. He might not be." *Senate Hearings* 6556.

17. S. 3420, as reported Senate, April 20, 1934. Like H.R. 8720, it included sale and repurchase transactions and deleted tippee and criminal liability.

The Senate report[18] states clearly that Congress considered access to inside information as the "basis" for initiating the special type of speculation it sought to bar:

> "The bill further aims to protect the interests of the public by preventing directors, officers, and principal stockholders of a corporation . . . from speculating in the stock on the basis of information not available to others,"[19]

and it specifically spoke of information obtained in advance of such trading:

> "trading in the stock of their own companies with the benefit of advance information. . ."[20]

The Senate passed this version on May 14, 1934, as an amendment to the House bill. The differences were referred to a conference, which substantially accepted the Senate version[21]. This bill became law.

Section 16(b) was presented to Congress and considered by it as a specialized tool to combat the unfair use of inside information in short-term "speculative swings"[22]. The hearings all concern the insider who obtains inside information in advance of his short-swing transaction and could "with his inside information get in and get out of stock within six months."[23]

Allis mistakenly argues that by deleting the reference to "the intention" at the time of purchase "of selling the same

18. S. REP. No. 792, 73d Cong., 2d Sess. (April 17, 1934).

19. *Id.* 9.

20. *Id.* 9.

21. See S. DOCT. No. 185, 73d Cong., 2d Sess. 16-17 (May 28, 1934); H.R. REP. No. 1838, 73d Cong., 2d Sess. 16-17, 35-36 (May 31, 1934).

22. *Senate Hearings* 6557.

23. *House Hearings* 133.

security," Congress "intended to broaden the bill" (Allis Br. 16), though it concedes that the language clearly "tended to limit its application to transactions involving shareholders with pre-existing 10% holdings" (Allis Br. 15), as does petitioner (P. Br. 29). In fact the "intention" language was removed solely because the elimination of possible criminal liability made intention entirely unnecessary as a component of proof, but it obviously did not change the target of the statute.

Indeed, rather than "broadening" the act, Congress drastically narrowed it in several ways: by excising tippee liability, raising share ownership to 10%, authorizing administrative exemptions, delimiting the statutory purpose, and adding the exemptive proviso excluding 10% shareholders who were not such "both at the time of the purchase and sale."

No doubt the exemptive proviso expressly for shareholders responds to congressional reluctance to make the same conclusive presumption for investors as for officers and directors. See page 13, *supra*. The Senate report[24] recounts, *inter alia,* an abuse whereby two directors manipulated dividend payments to make profits in a trading pool. It has been reasoned that §16(b) might in certain cases be applied to deter "official" insiders, with inherent corporate powers, from such manipulations occurring after the purchase. The present Chief Justice, writing in *Adler v. Klawans,* 267 F.2d 840 (2 Cir. 1959), so noted in circumstances specifically showing the special power of an "official" insider:

> "Our primary holding simply gives effect to the statutory mandate which presupposes that, at some moment before making a sale of stock, the insider was in an *official position* which he *could have used to influence the sale price.* (*Supra,* 267 F.2d 845.)" *Id.* 848 (Emphasis added to emphasis in original)

24. S. REP. No. 792, 73d Cong., 2d Sess. 9 (April 17, 1934).

The court, on specific and compelling facts, addressed managerial "manipulation" of corporate affairs to influence the price of the stock. But in doing so, the court drew a clear line between officers and directors on one hand and beneficial owners on the other:

> "The statute itself, independent of its legislative history, seems to treat directors and officers as one category of 'insiders' and 10% beneficial owners as another. There is, of course, a logical and practical basis for distinction. Generally . . . officers and directors have more ready access to the intimate business secrets of corporations and factors which can affect the real and ultimately the market value of stock than does even so large a stockholder as a '10% beneficial owner.' This is not to discount the potential influence of the [mere investor] but simply to acknowledge the basis for the different treatment accorded them by Congress. Moreover, a director or officer can usually stimulate more directly actions which affect stock values and have knowledge of factors which might depress values. Notwithstanding exceptions and variations these general propositions have a foundation in experience and furnish an adequate basis for a difference in treatment of 10% owners. *Beyond doubt it was considerations of this character which led Congress to make a provision concerning 10% owners which was not made with respect to officers and directors.*" *Id.* 845 (emphasis supplied).

An officer or director has not only a power, but a duty, to learn pertinent facts and to direct company policy. An investor, to the contrary, has no official powers (indeed he may in fact have no access to corporate information). The report summarizing the Senate investigations which led to the 1934 Act draws the same distinction. In the case of management, it pointed to:

> "the flagrant betrayal of their fiduciary duties by directors and officers of corporations who used their positions of trust *and* the confidential information . . ." S. Rep. No. 1455, 73d Cong., 2d Sess. 55 (June 6, 1934) (emphasis supplied),

while the general characterization of the investor's ability was limited to access to information:

> "stockholders who, while not directors and officers, exercised sufficient control over the destinies of their companies to enable them to acquire and profit by information not available to others." *Id.*

The facts in Allis' suit against G&W point up this very distinction. The testimony of Allis' chief executive was replete with instances when critical corporate matters were kept from G&W expressly because disclosure rules forbade discussion "outside of a board of directors' room", or because the subject was "an internal matter" which "should be kept to the board of directors and the management." No G&W representative ever sat on Allis' board, nor did G&W participate in any management decisions. Indeed, Allis took every step to isolate what it has described as an "unwanted mate". The district court concluded "that Allis sought to discourage G&W's retention of its stock position in Allis." 372 F. Supp. at 579.

The contentions that certain "exemptions" prove by indirection that § 16(b) attacks an initial purchase by an "outsider" (because otherwise the exemption would be unnecessary) are clearly backwards bootstrapping, and they are erroneous on other grounds. For example, the discussion of arbitrage (P. Br. 30; Allis Br. 16; *Senate Hearings* 7567) reflects concern that an arbitrageur may "accumulate more than 5 percent," become a statutory "insider", and be restricted in trading by the act, "which imposes penalties upon a stockholder owning 5 percent or more . . ." *Id.* Such discussion is not directed to the initial purchase. Indeed,

arbitrage by preexisting "insiders" initially raised § 16(b) questions, see *Falco* v. *Donner Foundation, Inc.*, 208 F.2d 600 (2 Cir. 1953), but these were resolved by § 16(d) (now § 16 (e)), exempting arbitrage transactions. Moreover, contrary to the statement at Allis Br. 17, the arbitrage subsection was not even in the bill[25] discussed in the passage quoted.

Rule 16b-2 (P. Br. 24, 30; Allis Br. 17) is likewise unhelpful to petitioner and Allis, for it too applies to officers, directors, and preexisting "beneficial owners". Indeed, in explaining Rule NB2, the ancestor of Rule 16b-2, the SEC clearly had the model of a pre-existing relationship in mind:

> "The new Rule NB2 affords an exemption for certain cases by providing that underwriters who happen to have a member of their firm also an officer or director of the issuer or one of its principal stockholders who are regularly engaged in the business of buying and selling securities need not account to the company for profits realized from purchases and sales made in the distribution of a security for the company, provided that independent underwriters have a participation in the underwriting of at least 50 per cent on identical terms." SEC Securities Exchange Act Release No. 264 (June 8, 1935).

Finally, petitioner and Allis swing wide of the mark in trying to divine the intent of the 73rd Congress from § 16(d) (P. Br. 30; Allis Br. 17), apparently overlooking the fact that this subsection 16(d) was passed by the 88th Congress in 1964.[26]

25. H.R. 8720; see *Senate Hearings* 7539.

26. Apart from the anachronism, their logic is erroneous. Section 16(d) leaves untouched market-making transactions by a dealer previously holding securities of the issuer in a segregated "investment" account, but it fully exempts persons previously holding over 10% in "trading accounts" as well as dealers who are officers or directors. *See* H. R. Rep. No. 1418, 88th Cong., 2d Sess. (1964), U.S. Code Cong. & Admin. News, 88th Cong., 2d Sess. 3025, 3042-43 (1964).

C. The elaborate theories advanced to support first-transaction liability conflict with the legislative purpose and the logic of the statute itself.

Very much mistaken as to the legislative history, the proponents of liability indulge in latter-day creation of new rationales. Allis relies exclusively upon the theory of "after-acquired information", claiming that a "purchase of a large block of securities followed by access to inside information and sale thereof within a six-month period was precisely the situation intended to be covered by § 16(b)" (Allis Br. 5). Congress intended precisely the opposite, as shown above, and included only transactions in which inside information precedes and motivates the first transaction, so that a "sure-thing" profit can be made in the second.[27] The "initial transaction . . . is an anticipatory action based upon inside information, and the terminal transaction is the profit-taking action." Comment, *supra,* 20 U.C.L.A. L. Rev. at 1295 (footnote omitted). To base automatic liability on access to information only after the first transaction departs from the aim of the statute and cannot be justified. *Id.* 1295-97. *Accord: Gold* v. *Sloan, supra,* 486 F.2d at 349. Possible use of information acquired after the initial transaction, commentators have noted, is simply not a § 16(b) problem—but clearly is a 10b-5 problem. Note, *supra,* 72 Mich. L. Rev. at 607 n.55; Note, *supra,* 117 U. Pa. L. Rev. at 1042 n.39; *Lowenfels, supra,* 54 Cornell L.Q. at 61-63.

27. "[T]he terms of the statute and its legislative history, both . . . indicate that only double-transaction abuse rather than single-transaction abuse was intended to be reached. The congressional hearings . . . repeatedly describe its purpose in terms referring to double- rather than single-transaction abuse—the curbing of 'short-term', 'in-and-out' speculation on the basis of inside information. Furthermore, the examples in the congressional hearings and reports of the kind of abuse intended to be reached by section 16(b) include no instances of single-transaction abuse, but in all cases describe situations in which advance information tainted both the purchase and the sale." Note, *supra,* 72 Mich. L. Rev. at 602-03.

Indeed when such a theory of liability is tested, the structure of the statute breaks down. For example, the six month period, "under the statute itself, is assumed to dissipate whatever trading advantage might be imputed to a major stockholder", *Kern County Land Co.* v. *Occidental Petroleum Corp., supra,* 411 U.S. at 603. But if liability is based on supposed information acquired *after* the six months start to run, "the six month time period is illogical", Note, *supra,* 72 MICH. L. REV. at 605. The key provision "loses its efficacy as a presumptive device", Comment, *supra,* 20 U.C.L.A. L. REV. at 1297.

Moreover, the presumption of abuse which is the core of the statute simply cannot apply. Section 16(b) presumes that a short-term purchase and sale preceded by access to inside information is abusive. But no inference can arise if only the sale can be connected with hypothetical inside information:

> "[R]ecovery under section 16(b) is based on a presumption of abuse arising when an insider buys and sells at a profit within six months. . . . If the statute were read to reach single-transaction abuse, the required facts would be insufficient to justify the presumption of actual abuse. The occurrence of two transactions within a short time—a fact that would otherwise indicate double-transaction abuse—cannot justify the presumption of guilt when the initial transaction is, by hypothesis, unrelated to the later transaction." Note, *supra,* 72 MICH. L. REV. at 607-08.

Similarly, such a theory renders the statutory measure of recovery wholly inappropriate. Recovery under § 16(b) is the difference between the purchase price and the sale price —which works well when the theory is that the insider bought stock with inside information, realizing his profit upon the sale. But under a theory based upon post-acquisition information, this measure of recovery does not work

at all, for the insider can only sell at a price higher than some other selling price. The measure of his unfair advantage is the difference between these two selling prices. Section 16(b) cannot measure that profit (Rule 10b-5 can, however[28]). Only by accident will the difference between the purchase price and sale price equal the difference between the two sale prices. The investor would pay a recovery as if he purchased with inside information, which by hypothesis cannot be presumed.

This gross incompatibility between the spurious post-purchase information theory and the statute's operation[29] has serious Constitutional implications beyond the demonstrable conflict with Congressional intent. Section 16(b), which imposes liability in the absence of actual wrongdoing, has

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28. Under Rule 10b-5 the damage award attacks the abuse precisely; a wrongdoer can be charged with the difference between his sale price and the market value that the stock attained after the inside information became public. *See, e.g., SEC* v. *Texas Gulf Sulphur Co.,* 446 F.2d 1301, 1307-08 (2 Cir. 1971), *cert. denied,* 404 U.S. 1005 (1972).

29. This incompatibility always compels a recovery which bears ***no relation at all*** to the "profits" made by use of inside information, *e.g.:*

An outsider buys over 10% of an issuer's stock for $20 per share. The stock soon rises to $50 per share. Less than 6 months after his purchase he learns unfairly that earnings will decline, and he sells for $50 per share. When the lower earnings are made public, the market price drops from $50 to $45. By his abuse of information he has gained an unfair advantage of $5 over the public stockholders. But Allis' theory would charge him with a $30 recovery instead.

Or take the converse case: He initially purchases stock at $20 per share, and it rises to $25 in five months. At that time he learns "inside information" that earnings will be seriously cut, and he immediately sells his stock at $25. When the news comes out the stock tumbles from $25 to $10 per share. Clearly by his abuse of inside information he has gained an unfair advantage of $15 over public stockholders. But Allis' theory would charge him with only a $5 recovery.

All such results are obviously irrational. The only time an insider would be charged with an amount related to his unfair gains is if the appreciation of his stock while he owns it exactly equals its decline after his sale, and such an instance is sheer accident.

been sustained only on the basis of its "remedial" quality calling for forfeiture only of "unfair profits", and a reasonable relationship to the supposed unfair conduct.[30] But in the case of an outsider's purchase, the result is a capricious, irrational penalty, bearing no relationship to any "profit realized" from "the unfair use of information".

Petitioner quotes an argument once made by the SEC, as *amicus curiae*[31], suggesting that an over-10% investor must have pre-purchase inside information since he "necessarily would deal in the negotiations looking toward the purchase, with either the issuer or an insider holding a large interest in the issuer" (P. Br. 27). Obviously this theory is woefully inadequate in describing the likely means of achieving a stock interest, and, in addition, relies upon a presumption contrary to the statute itself.[32]

This Court expressly rejected such an imputation in *Kern County,* where it held claims of information based on "substantial stockholdings that did not yet exist" to be improper, 411 U.S. at 597. Similarly, to base liability on a supposed pre-purchase "tip" from an insider is also clearly improper, since Congress deliberately deleted "tippee" liability, and it would impermissibly expand liability beyond those "specifically designated by Congress to suffer those losses."

30. *Smolowe* v. *Delendo Corp.*, 136 F. 2d 231, 239 (2 Cir.), *cert. denied,* 320 U.S. 751 (1943); *see also Booth* v. *Varian Associates,* 334 F. 2d 1, 3 (1 Cir. 1964), *cert. denied,* 379 U.S. 961 (1965); *Adler* v. *Klawans, supra,* 267 F. 2d at 844.

31. Brief for SEC as Amicus Curiae at 5-6, *Stella* v. *Graham Paige Motors Corp.*, 104 F. Supp. 957 (S.D.N.Y. 1952).

32. Indeed, this merely points out another valid distinction between managerial insiders and shareholders. The latter can acquire their position without any inside access, through exchange and tender offers and market purchases, some of which may indeed require extensive prepurchase disclosure. Certainly, Congress refused to presume that one who becomes a "beneficial owner" had a prior insider's relationship, since all concede that it exempted purchases occurring before 10% status, even if there are short-term sales occurring after the statutory status has been reached.

Reliance Electric Co. v. *Emerson Electric Co., supra,* 404 U.S. at 427; *Blau* v. *Lehman, supra,* 368 U.S. at 411.

Petitioner seems to argue at length (P. Br. 33-35) that this Court's refusal to presume access to information in the absence of the required shareholdings was erroneous, by claiming that the statutory language can be construed to include ownership of securities convertible into the required holdings or binding contracts to buy such holdings. The short answer is that the argument is irrelevant where the investor holds no securities of the issuer whatever before the purchase (much less common stock equivalents) and holds no such contract. Indeed, whether a particular contract for the purchase of securities can be the basis for a §16(b) claim depends, at the least, upon affirmative proof that it conveyed substantial prepurchase rights of ownership and was intertwined with unfair access to inside information (see *Newmark* v. *RKO General, Inc.*, 425 F.2d 348, 356 (2 Cir.), *cert. denied,* 400 U.S. 854 (1970))—the very elements which petitioner would assume by means of an improper presumption.

Petitioner's argument that an investor could acquire over ten percent in hopes of manipulating market prices to sell at a profit (P. Br. 28) simply ignores the limits and stated purpose of § 16(b). It clearly was not designed to provide recovery based on every litigant's fantasized claims of hypothetical wrongdoing. There are extraordinarily effective federal remedies for actual wrongdoing. Indeed, the claim that "official" insiders' liability is an "analogous issue" to the question presented here (P. Br. 15) is plainly erroneous, for it ignores precisely the distinction which the statute draws.[33]

Nor is it relevant that the acquisition of over ten percent must be reported pursuant to § 16(a) (P. Br. 32), since

33. Thus cases involving officers or directors (P. Br. 23) are inapposite here.

§ 16(a) reporting rules are not intended to determine § 16(b) liability, see *Chemical Fund, Inc.* v. *Xerox Corp.*, 377 F.2d 107, 112 (2 Cir. 1967); *Silverman* v. *Landa*, 200 F. Supp. 193, 195 (S.D.N.Y. 1961), *aff'd*, 306 F.2d 422 (2 Cir. 1962), and serve different purposes,[34] including publicity alone. See H.R. Rep. No. 138, 73d Cong., 2d Sess 13 (1934).

Finally, petitioner argues that the "outsider's" estimates of the future value of the assets he exchanges for stock (P. Br. 53-55), may be substituted for the required access to confidential information of the issuer. This is a baseless expansion of the statute, applicable only when the acquisition is from the issuer, and then only when nonmonetary consideration is paid, and as such is clearly not a credible, much less authentic, basis for "automatic" liability.

D. The decisions of this Court clearly reject the attempt to take § 16(b)'s automatic liability beyond its intended limits.

It seems to be contended (P. Br. 36; Allis Br. 8) that the Court in *Kern County* decided that an outsider's over-ten per cent purchase is chargeable since the Court went on to decide whether a "sale" took place. Initially, it is simply unacceptable to argue that this Court, which expressly reserved the issue in *Reliance Electric* where it was arguably involved (404 U.S. at 421), would decide it by indirection in *Kern County,* where it was not involved at all. There Occidental made an unconditional tender offer and bought shares in many separate transactions as they were tendered. *After* acquiring over 10% it extended its offer and made a series of purchases *after* becoming a "statutory insider". See 411 U.S. at 591 n.20, 598. Occidental never

34. "It is recognized that many reports are required by Section 16(a) of transactions which are not subjected to Section 16(b) liability." SEC Securities Exchange Act Release No. 4801 (Feb. 20, 1953).

raised the first-purchase issue because it was immaterial,[35] and Occidental had more important concerns. Rather, it sought to free *all* shares from liability by attacking the alleged "sale".

To the contrary, the analysis in *Kern County* certainly bars liability here. There, the Court noted that Occidental lacked large shareholdings, and it thus viewed its initial purchases as statutorily innocent, even though made in a cash tender offer which required no prospectus disclosure:

> "[I]t owned only 1,900 shares of Old Kern stock, far fewer than the 432,000 shares needed to constitute the 10% ownership required by the statute. There is no basis for finding that, at the time the tender offer was commenced, Occidental enjoyed an insider's opportunity to acquire information about Old Kern's affairs." *Id.* 596-97.

Rejecting the contention that Occidental should be held to have foreseen a profitable "defensive" merger, the Court said:

> "Calculations of this sort, however, whether speculative or not and whether fair or unfair to other stockholders or to Old Kern, do not represent the kind of speculative abuse at which the statute is aimed, for they *could not have been based on inside information obtained from substantial stockholdings that did not yet exist.*" *Id.* 597 (emphasis supplied).

Even though Occidental had extended its offer *after* it became a 10% "beneficial owner" and bought more stock, the

35. The 10% purchase issue was worthless to Occidental and was not argued. Occidental purchased stock piecemeal as it was tendered, and the initial purchase that put it over 10% was a single tender at 2:46 p.m. on May 10, 1967. Excluding that initial purchase was meaningless to Occidental. Instead, it sought exclusion of all sub-10% purchases. Brief for Defendant-Appellant at 85, *Abrams* v. *Occidental Petroleum Corp.*, 450 F.2d 157 (2 Cir. 1971), *aff'd sub nom. Kern County Land Co.* v. *Occidental Petroleum Corp.*, *supra.*

Court rejected liability in light of the hostile relationship with the issuer. And, treating the option issue in that case, the Court stressed again the need for actual ownership in the issuer:

> "Occidental had no *ownership position* in Tenneco *giving it any actual or presumed insights* into the future value of Tenneco stock. That was the *critical item of intelligence* . . ." *Id.* 603 (emphasis supplied).

Under this decision it simply cannot be argued that an initial 10% purchase by an outsider with no previous "relationship to the issuer" could be viewed as tainted.

None of the remaining decisions cited by petitioner and Allis, to the extent they remain viable after *Kern County,* support liability here.

Newmark v. *RKO General, Inc., supra,* expressly rejects the idea that an "outsider's" purchase could be based on inside information, 425 F.2d at 356. There the court found that the defendant became a statutory "beneficial owner" and actually had inside information *before* making its purchase,[36] and it put liability on that basis:

> "At the time it secured a conditional right to purchase Central securities, RKO *was in possession of advance information* of the type most likely to affect the price of Central shares—confidential knowledge of an impending merger with Frontier." *Id.* (emphasis supplied).

36. "[O]n the facts before us, we have no difficulty in deciding that RKO became a beneficial owner of more than ten percent of Central's common stock before its purchase of Central shares. . . . RKO entered into an agreement which granted it a conditional right to purchase more than 50% of Central's common stock at a fixed price, ensured that Central would be managed in accordance with its interests, and required a majority of Central shares to be voted in support of a merger it favored. This contract, we conclude, granted rights of ownership, particularly those rights most important to the speculative purchaser, so substantial as to make RKO a ten percent beneficial owner of Central at that time." 425 F.2d at 356.

Thus the transaction occurred in the critical statutory sequence:

> "Accordingly, we conclude that RKO *became a Central insider, purchased* Central securities and, less than six months later, *sold* these securities." *Id.* (emphasis supplied).

Allis relies (Allis Br. 9-11) on the lower court ruling in *Emerson Electric Co.* v. *Reliance Electric Co.,* 434 F.2d 918 (8 Cir. 1970), on a point not pursued in this Court, but this decision is of infirm validity after *Kern County.* The investor in *Emerson* bought 13% ownership in a pre-Williams Act cash tender offer and urged that the purchase was excluded by the exemptive proviso. The court sought to justify liability on the basis of a situation not before it, hypothesizing "potential mischief" different from the statute's intended target:

> "Illustrative of some of the mischief that would be permitted in spite of Congress' action in enacting 16(b) if we accorded with Emerson's contentions is an initial purchase of as large a block of stock as 51 percent or more of a corporation's stock, followed by a sale any time within six months by the stockholder who obviously within that period could obtain much inside information and also could influence, manipulate, or control corporate transactions. The deterrence of such apparent potential mischief must have been within the contemplation of Congress." *Id.* 924.

To base liability on a hypothetical 51% acquisition followed by supposed manipulation, when the case actually involves a non-controlling 13% shareholder rejected by management, conflicts with *Kern County,* under which courts are to consider "whether *the transaction* may serve as a vehicle for the evil Congress sought to prevent," 411 U.S. at 594 (em-

phasis supplied); see also *id.* 594 n.26, 595. Furthermore, at least insofar as § 16(b) relates to mere investors, its expressed concern is abuse of information, not hypothesized manipulation. *Adler* v. *Klawans, supra.*

More basically, the Eighth Circuit was primarily motivated by the thought that § 16(b) should include any "profits" from opportunities created by defensive tactics in contests for control:

> "An insider engaged in a contest for control of its stock issuer may have substantial opportunity for short-term profits perforce of its substantial stock ownership. In less than three months from its stock purchase Emerson apparently had made substantial short term profits related to its stock acquisition activities in its effort to gain control of Dodge." *Id.* 924 (footnote omitted).

But the Court in *Kern County* later held, expressly to the contrary, that use of inside information—not calculations related to contests for control or the advantage of "leverage" from "large stock ownership itself", 411 U.S. at 602—is the only concern of § 16(b). "If there are evils to be redressed by way of deterring those who would make tender offers, § 16(b) does not appear to us to have been designed for this task." *Id.*, 597-98.

The facts in *Stella* v. *Graham-Paige Motors Corp.*, 104 F. Supp. 957, *aff'd in part, remanded in part*, 232 F. 2d 299 (2 Cir.), *cert. denied*, 352 U.S. 831 (1956), do not support liability here.[37] *Stella* involved a large shareholder which cofounded the issuer and originally owned 50% of its stock, which holdings were recently diluted through newly issued

37. The entire "first purchase" issue in *Stella* was actually moot, because there was no "profit realized", *Stella* v. *Graham-Paige Motors Corp.*, 259 F. 2d 476 (2 Cir. 1958), *cert. denied*, 359 U. S. 914 (1959), and profit is a substantive element of liability under § 16(b), *Blau* v. *Lamb*, 163 F. Supp. 528, 532 (S.D.N.Y. 1958).

shares to 6.25%. Its purchase, raising its interest to 21%, was made pursuant to a voting trust agreement with the other founder of the company, which itself owned 9.25% of the stock (104 F. Supp. at 958). The court was faced with an insider-in-fact before the purchase.

The court interpreted § 16(b) solely to deter double-transaction abuse, where inside information *pre-dates* both the purchase and the sale. The defendant argued that an initial transaction could never create liability, but the court raised the problem of persons with a *previous* inside "relationship to the issuer" (the very case before it):

> "If the construction urged by the defendant is placed upon the exemption provision, it would be possible for a person to purchase a large block of stock, sell it out until his ownership was reduced to less than 10%, and then repeat the process, ad infinitum." 104 F. Supp. at 959.

Obviously this reasoning only applies in a case of *recurrent* insider status (as in *Stella* itself) and would have no bearing on an investor with no previous relationship to the issuer. Moreover, the expansionist basis of *Stella* is not viable after *Reliance Electric*. There the Court, holding that the exemptive proviso excluded the second sale, specifically rejected so-called "policy" arguments designed to bring it within the act by evidence of a pre-existing intent, or by using a "presumption of a taint" based on a recent, but not current, "inside" relationship (404 U.S. at 423, 424).

The general claims that this Court should ignore the terms and delimited purpose of the statute in order to construct liability and thus prevent supposed "loopholes" or "evasions" of the "policy of § 16(b)" (P. Br. 28; Allis Br. 9) merely beg the question by assuming that Congress intended the "proofless" recovery of § 16(b) to be applied loosely and without limits, and specifcially err in ignoring

precedents against "adding to the 'prophylactic' effect Congress clearly prescribed in § 16(b)", *Blau* v. *Lehman, supra,* 368 U.S. at 411.

The statutory exemption cannot be ignored, *Reliance Electric Co.* v. *Emerson Electric Co., supra,* 424, but must be construed by "endeavoring to implement congressional objectives without extending the reach of the statute beyond its intended limits." *Kern County, supra,* 411 U.S. at 594-95. Those objectives cannot be served by imposing a liability which is fabricated by artificially attaching the label of "insider trading" to an innocent transaction by an outsider, and presuming unfairness without any foundation in reason or fact, contrary to the legislative intent.

Conclusion

The judgment of the Court of Appeals for the Ninth Circuit is correct in its application of §16(b) and should be affirmed.

Respectfully submitted,

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